

Michigan Notes to the Financial Statements

Statutes provide for certain special State investment programs for which the General Fund is credited (charged) for earnings in excess of (under) those achieved by regular pool investments. There have been no principal losses because of these programs to date.

Emergency Financial Assistance Loan Program: This program provides for emergency loans to local units of government, and is the most significant of the special investment programs. The Emergency Financial Assistance Loan Board, established by P.A. 243 of 1980, administers the program. The Treasurer may not loan more than a combined total of \$5 million in any one fiscal year to qualifying cities, villages, or townships in amounts as approved by the Board.

In fiscal year 1999-2000 the Emergency Financial Assistance Loan Board was authorized to approve the lending of up to \$159.9 million to Wayne County to finance the payment of certain obligations to the State. The outstanding balance at September 30, 2002, was \$44.4 million. Loan repayments by the County are supported by provisions of the loan agreement and legislation that pledge the County's share of a portion of the State collected taxes on cigarettes. There were no repayments on the loans in fiscal year 2001-2002.

Michigan Marina Dredging Loan Program: Public Act 280 of 2000 provides for a program under which financial institutions may make low-interest loans to eligible marinas for dredging costs necessitated by low water levels to accommodate the use of the marina by recreational watercraft.

Under this program, the Department of Treasury and a financial institution may enter into an investment agreement under which the Department of Treasury will invest the State's Common Cash with the financial institution at an agreed upon interest rate (generally 1.5 percent per annum). The financial institution will then use the principal to make a low-interest loan to an eligible marina.

The Act specifies that the maximum amount of a Michigan marina-dredging loan is \$75 thousand per marina. The total amount of outstanding loans is statutorily limited to \$20 million. The loans accrue at an interest rate of six percent, and the loans' terms may not exceed seven years. Other details about the loans are available in the investment agreement. The total amount loaned in fiscal year 2001-2002 was \$.7 million; repayments during the year were \$174 thousand.

Michigan Sugar Beet Loan Program: Public Act 123 of 2001 provides for a program in which the State may make no-interest loans from the Common Cash pool to sugar beet growers' cooperatives for the purpose of buying the assets of agricultural processors who are in or have recently been in bankruptcy proceedings.

The Act specifies that the loans may not exceed \$5.0 million in total, with loan periods not to exceed 5 years. As of September 30, 2002, the loans outstanding totaled \$5.0 million, with maturity dates of February 1, 2007.

Agriculture Disaster Relief Program: Public Act 16 of 2002 created this program to provide loans to assist farmers and businesses suffering losses as a result of a disaster. Financial institutions (banks) making these loans can have the cost of the loan covered by (1) earnings on funds deposited by the State, or (2) subsidy of the cost.

The maximum loan is \$150 thousand (\$200 thousand under certain circumstances) to farmers and \$400 thousand per legal entity to businesses. The total amount the State may deposit under this program is \$30.0 million. Of that amount, no more

than \$10.0 million may be allocated to qualified agricultural loans made to businesses. Details on what constitutes a qualified loan can be found in the statute. Loans must be made before October 1, 2002, and must be repaid by October 1, 2007.

As of September 30, 2002, the State had deposited a total of \$6.8 million with three different financial institutions. There were no subsidy payments.

Assets and equities of the Common Cash pool as of September 30 were as follows (in millions):

ASSETS	
Cash on hand	\$ -
Demand deposits	228.5
Time deposits - regular	52.9
Time deposits - Marina Loan Programs	.5
Time deposits - Agricultural Loan Program	6.8
Prime commercial paper - at cost	2,815.4
Interest receivable	4.3
Emergency loans to local units - at cost	44.6
Michigan Sugar Beet Loan Program	5.0
Total assets	<u>\$ 3,158.0</u>

EQUITIES	
Fund equities (net) in Common Cash (1):	
Governmental activities	\$ 2,731.3
Business-type activities	75.7
Fiduciary funds	193.9
Discretely presented component units	157.1
Net fund equities	<u>\$ 3,158.0</u>

(1) Negative equity balances in the pool are reclassified at year-end as interfund receivables and liabilities. Current balances are included with "Amounts due from other funds" and "Amounts due to other funds" and long-term amounts are classified as interfund advances. Note 17 summarizes interfund receivables and liabilities.

The following paragraphs provide disclosures about deposits and investments of the Common Cash pool, as required by GASB Statement No. 3. Please see Note 8 for a description of the GASB custodial credit risk categories and for information about deposits and investments, which are not part of the Common Cash pool.

Deposits

At September 30, 2002, the carrying amount of deposits, including time and demand deposits, was \$288.7 million. The deposits were reflected in the accounts of the banks at \$288.7 million. Of the bank balance, \$7.0 million was covered by federal depository insurance (GASB credit risk category 1), \$281.5 million was collateralized with securities held by the State's agent in the State's name (GASB credit risk category 1), and \$.1 million of demand deposits which are uninsured and uncollateralized (GASB credit risk category 3). Compensating balances kept in demand deposit accounts to avoid service charges totaled \$333.2 million at September 30, 2002.

Investments

Using the GASB categories of custodial credit risk, all of the investments (including prime commercial paper, corporate bonds, and emergency municipal loans) are in category 1. The sugar beet loans are evidenced by zero coupon corporate bonds. The emergency municipal loans are evidenced by notes held by the State in the State's name, so they fall in custodial credit risk category 1. At September 30, 2002, the fair value of prime commercial paper was \$3.8 billion.

NOTE 6 – TAXES RECEIVABLE

Taxes receivable represent amounts due to the State at September 30, for revenues earned in fiscal year 2001-2002, which will be collected sometime in the future. Amounts expected to be collected in the next fiscal year are classified as "current" and amounts expected to be collected beyond the next fiscal year are classified as "noncurrent." The receivables have been recorded net of allowances for uncollectibles. Sales, use, single business, and income taxes are accrued to the extent that the related sales, wage, or activity being taxed occurred prior to October 1. Property taxes receivable are accrued when taxes are levied against the property owners.

In the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting. In the governmental fund financial statements, revenue is recorded using the modified accrual basis of accounting for amounts due to the State at September 30 (as stated above) that are considered "available" (e.g. received by the State within approximately 60 days after that date). The remainder is recorded as deferred revenue. Annual tax payments (i.e., those paid with an annual return, such as individual personal income taxes filed in April)

have not been accrued because they are neither reasonably estimable nor available. The State accrues single business taxes received prior to December 1 (i.e., quarterly filings due October 31).

Local units of government, as agents for the State, assess the State property tax. Taxes are due and payable at the same time as local unit taxes and are generally divided into a summer portion payable to the local units on the succeeding July 1 and a winter portion due December 31. Beginning in fiscal year 2002-2003, local units will be required to levy property taxes in July. The State accrues revenues received by the State or the local units, on its behalf, during October and November. Since the property taxes are levied and received by the local units, it is not feasible for the State to measure and record delinquent amounts receivable and, therefore, no delinquent amounts are recorded or reflected in the table below. The accrued telephone and telegraph taxes are due December 1 and were received at approximately that time. Delinquent taxes are recognized to the extent that they will be collected within 12 months.

Taxes receivable as of September 30, consisted of the following (in millions):

Tax	General Fund	Special Revenue Funds	Total
Sales & use	\$ 308.2	\$ 600.1	\$ 908.3
Individual income	1,455.4	196.7	1,652.1
Single business	1,589.1	-	1,589.1
State education (property)	-	592.0	592.0
Telephone & telegraph	69.3	-	69.3
Motor fuel	-	403.1	403.1
Insurance - retaliatory	67.5	-	67.5
Estate & inheritance	26.5	-	26.5
Tobacco products	44.8	56.7	101.4
Other	27.8	60.9	88.7
Penalties and interest	1,030.3	.2	1,030.5
Gross taxes receivable	4,618.8	1,909.6	6,528.5
Less allowance for uncollectibles	1,754.9	546.8	2,301.8
Total taxes receivable (net)	<u>\$ 2,863.9</u>	<u>\$ 1,362.8</u>	<u>\$ 4,226.7</u>
<u>As reported on the financial statements</u>			
Current taxes receivable	\$ 2,610.0	\$ 1,308.2	\$ 3,918.1
Noncurrent taxes receivable	253.9	54.6	308.5
Total taxes receivable (net)	<u>\$ 2,863.9</u>	<u>\$ 1,362.8</u>	<u>\$ 4,226.7</u>

NOTE 7 – JOINT VENTURES AND AFFILIATED FOUNDATIONS

A. Joint Ventures - Primary Government

The State participates in two joint ventures as described below. Joint ventures are not reflected as component units within this report because they do not meet the GAAP criteria for inclusion. Their separately issued financial statements may be obtained by directly contacting the applicable organizations. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

Great Lakes Protection Fund

(GLPF) is a not-for-profit corporation located in Evanston, Illinois. Its purpose is to finance and support research with respect to water quality of the Great Lakes. The eight states bordering the Great Lakes are eligible to become members if they make a required contribution to the endowment of GLPF.

Contribution requirements were established based upon water consumption and usage. Contributions to GLPF are permanently restricted and are not available for disbursement. Michigan is the largest contributor, having made a contribution of \$25.0 million, constituting approximately 31% of the total. Michigan made its required contribution by issuing GLPF a general obligation bond authorized as part of the State's environmental protection bond program. No additional contributions from Michigan will be required.

Two members on GLPF's board of directors represent each of the participating seven member states. The states' respective governors select the board members. Directors control GLPF's financing and budgeting operations, within requirements established by the Articles of Incorporation. One-third of the net earnings on total contributions (after operating expenses) is granted to the respective states in proportion to their contributions to GLPF. Two-thirds of the net earnings are available to GLPF to make other grants. The State's equity

interest in GLPF of \$25.0 million is reflected as an asset in the government-wide statements.

Joint International Bridge Authority

The International Bridge in Sault Ste. Marie, Michigan is a joint venture of the State and Canadian governments. The Authority consists of six people, three appointed by each government. The Authority oversees the operations and maintenance of the Bridge. The International Bridge Administration, an administrative entity within the Michigan Department of Transportation, is responsible for the day-to-day operations of the Bridge. The Authority reimburses the State for costs incurred to provide these services.

For the 16-month period ending December 31, 2001 (the Authority's most recently audited financial statements), revenues exceeded expenses by approximately \$2.6 million. The Bridge and the ancillary assets on Michigan's side of the Bridge, in addition to one-half of the balance of funds not required to pay liabilities, represent the State's equity interest. The State is obligated to pay one-half of any claims incurred by the Authority that are not covered by insurance or existing resources. The State's equity interest of \$7.5 million is reflected as an asset in the government-wide statements.

B. Affiliated Foundations - Discretely Presented Component Units

Several of the State university component units are affiliated with independent corporate foundations that exist for the sole purpose of soliciting, collecting, and investing donations for the benefit of the universities. The operations and net assets of these foundations are not included in the financial statements of the universities due to their independence. At June 30, 2002, net assets held by these foundations totaled \$321.9 million.

NOTE 8 – DEPOSITS AND INVESTMENTS

A. General Information

This note provides information for all deposits and investments except those of the Common Cash pool, which are described in Note 5. GASB Statement No. 3 requires certain disclosures regarding policies and practices with respect to deposits, investments, and the custodial credit risk associated with them.

Deposits

In accordance with GASB Statement No. 3, deposits are classified into three categories of custodial credit risk as follows:

Category 1: Insured or collateralized with securities held by the entity or by its agent in the entity's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Category 3: Uncollateralized (this includes any bank balance that is collateralized with securities held by the pledging

financial institution, or by its trust department or agent, but not in the entity's name).

Investments

In accordance with GASB Statement No. 3, investments are also classified into three categories of custodial credit risk as follows:

Category 1: Insured or registered, or securities held by the entity or its agent in the entity's name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3: Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the entity's name. (This includes the portion of the carrying amount of any repurchase agreement that exceeds the fair value of the underlying securities.)

Certain types of investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. Deposits classified as investments on the balance sheet are included in the investment tables following and are categorized using the deposit risk category definitions.

In accordance with GASB Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, securities lent at year-end for cash collateral have not been categorized by custodial risk, while securities lent for securities collateral have been categorized.

B. Deposits and Investments - Primary Government

Deposits

In addition to equity in the Common Cash pool, some State funds maintain deposits with financial institutions. At year-end, the carrying amount of such deposits, excluding those classified as investments, was negative \$24.2 million, which was caused primarily by a net book cash overdraft in an account maintained by the Michigan Unemployment Compensation Funds (MUCF). The deposits were reflected in the accounts of the banks at \$15.9 million. Of the bank balances, \$.2 million was covered by federal depository insurance or by collateral held by the State's agents in the State's name (GASB credit risk category #1), \$14.8 million was covered by collateral held in the pledging banks' trust departments in the State's name (GASB credit risk category #2), and \$.9 million was uninsured and uncollateralized (GASB credit risk category #3).

Investments

Investment authority for the State's pension (and other employee benefit) trust funds is found in P.A. 314 of 1965, as amended. This act allows the State Treasurer, as investment fiduciary, to make diverse investments in stocks, corporate and government bonds and notes, mortgages, real estate, venture capital, and other investments. The act has prudence standards and requires that the assets of a retirement system shall be invested solely in the interest of the participants and beneficiaries and be made for the exclusive purpose of providing benefits to the participants and the participants' beneficiaries, and of defraying reasonable expenses of investing the assets of the State system.

The State Treasurer is also authorized to invest a limited amount of pension (and other employee benefit) trust funds in futures contracts. Such investments were made in Standard & Poors 500 and Standard & Poors Midcap Index futures

contracts during the year. There were no futures contracts outstanding as of September 30, 2002. Derivatives are used for a small amount of the pension (and other employee benefit) trust fund portfolios to provide additional diversification. However, derivatives are not used for speculation and they are not used to leverage the investment portfolios. Less than 8% of the total pension (and other employee benefit) trust funds portfolio has been invested from time to time in futures contracts and swap agreements. The swap agreements provide that the retirement systems will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Interbank Offered Rate (Libor), adjusted for an interest rate spread, on the notional amount stated in the agreements. United States domestic Libor-based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes. Swap agreements represent the largest category of derivatives used and total 7.3% of the total portfolio.

The investment authority for other State funds is found in their enabling statutes and/or their bond resolutions where applicable. Except as noted below, the investments of the non-pension (and other employee benefit) trust funds are comprised mostly of United States government securities.

The State Building Authority makes diverse investments as allowed by State statute and/or bond resolutions.

Investments of MUCF represent their interest in a U.S. Treasury trust fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act, which includes deposits from the unemployment compensation funds of various states. MUCF is credited quarterly with trust fund investment earnings, as computed on a daily basis.

The deferred compensation plans are invested in mutual funds, U.S. Treasury strips, money market funds, and pooled investment funds. During fiscal year 2001-2002, the deferred compensation plans' investment activities were managed by a private investment firm, which invests as directed by members of the plan.

As a matter of administrative policy, the State Treasurer makes only limited use of investments in repurchase agreements. No such investments were outstanding at year-end.

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The following table shows the carrying amounts and fair values of investments of the primary government by investment type and in total (in millions) at September 30:

	GASB Category				Total Carrying Value	Fair Value
	#1	#2	#3	Not Categorized		
Prime commercial paper	\$ 872.7	\$ -	\$ 17.3	\$ -	\$ 890.0	\$ 890.6
Money market funds	-	-	-	229.5	229.5	229.5
Government securities	5,494.6	-	233.6	21.4	5,749.6	5,749.6
Investment agreements	17.5	-	-	-	17.5	17.5
Corporate bonds and notes	3,732.7	-	-	-	3,732.7	3,732.7
Preferred stock	1.3	-	-	-	1.3	1.3
Equities	15,931.9	-	-	-	15,931.9	15,931.9
Mortgages	-	-	-	21.8	21.8	21.8
Real estate	-	-	-	3,928.0	3,928.0	3,928.0
Venture capital and leveraged buyouts	72.6	-	-	5,579.8	5,652.4	5,652.4
International	2,872.6	-	-	95.9	2,968.5	2,968.5
U.S. Treasury (unemployment) trust fund	-	-	-	2,357.7	2,357.7	2,357.7
Mutual funds	-	-	-	1,410.2	1,410.2	1,410.2
Pooled investment funds	-	-	-	1,920.6	1,920.6	1,920.6
Security Lending Transactions:						
Government securities	-	-	-	1,234.6	1,234.6	1,234.6
Corporate bonds and notes	-	-	-	94.1	94.1	94.1
Equities	-	-	-	587.3	587.3	587.3
Total Investments	<u>\$ 28,995.9</u>	<u>\$ -</u>	<u>\$ 250.9</u>	<u>\$ 17,480.8</u>	<u>\$ 46,727.6</u>	<u>\$ 46,728.2</u>

As Reported on Statement of Net Assets

Current investments	\$ 4,059.6
Noncurrent investments	42,668.0
Total investments	<u>\$ 46,727.6</u>

As Reported on the Statements of Net Assets and Statement of Fiduciary Net Assets

	Current Investments	Noncurrent Investments	Total
Governmental activities	\$ 451.2	\$ 442.2	\$ 893.4
Business-type activities	2,467.1	673.9	3,141.1
Fiduciary funds	912.9	41,780.2	42,693.1
	<u>\$ 3,831.3</u>	<u>\$ 42,896.4</u>	<u>\$ 46,727.6</u>

Pension (and other employee benefits) trust fund investments represent 85.0% of the total investments of the primary government. Other large holders of investments were the State Lottery Fund and MUCF.

The State Lottery Fund investments, \$783.3 million, are all in the form of zero coupon U.S. Treasury bonds. These investments are held to provide funding for deferred prize awards.

Securities Lending Transactions

Under the authority of P.A. 314 of 1965, the State lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The custodian is not liable for any losses unless there is negligence or willful misconduct on its part. State statutes allow the State to participate in securities lending transactions, via a Securities Lending Authorization Agreement, authorizing the agent bank to lend its securities to broker-dealers and banks, pursuant to a form of loan agreement. During the fiscal year, the agent bank, at the direction of the State Treasurer, lent securities and received: cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, and irrevocable bank letters of credit issued by a person other than the borrower or an affiliate of the borrower as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: 1) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and 2) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The State Treasurer did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment

pool. As of September 30, 2002, the investment pool had an average duration of 57 days and an average weighted maturity of 471 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2002, the retirement systems had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the State as of September 30, 2002, were \$2.1 billion and \$2.0 billion respectively.

C. Deposits and Investments - Discretely Presented Component Units

Deposits

At year-end, the carrying amount of discretely presented component units deposits, excluding those classified as investments, was \$205.7 million. The deposits were reflected in the accounts of the banks at \$197.6 million. Of the bank balances, \$11.1 million was covered by federal depository insurance or by collateral held by the component units' agents in the component units' names (GASB credit risk category #1), \$4.0 million was covered by collateral held in the pledging banks' trust departments in the component units' names (GASB credit risk category #2), \$122.8 million was uninsured and uncollateralized (GASB credit risk category #3), and \$59.7 million was held in money market funds which are not categorized.

Investments

The investment authority for most discretely presented component units is typically found in their enabling statutes and/or their bond resolutions where applicable. Those component units which are financing authorities generally may invest in government or government backed securities and deposits. The Michigan Education Trust's investments are subject to an investment agreement with the State Treasurer which allows the Treasurer, acting as agent, to make diverse investments including stocks, bonds, notes, and other investments. Investment policies for the State universities are typically set forth by their governing boards and include a broad range of investment types.

Restricted Assets

Restricted investments on the government-wide Statement of Net Assets, totaling \$1.2 billion, represent amounts that are pledged toward the payment of outstanding bonds and notes.

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The following table shows the carrying amounts and fair values of investments of the discretely presented component units, including

deposits classified as investments on the balance sheet, by investment type and in total (in millions):

	GASB Category				Total Carrying Value	Fair Value
	#1	#2	#3	Not Categorized		
Deposits(1):						
Time deposits	\$ 18.0	\$ -	\$ 46.9	\$ 2.0	\$ 66.8	\$ 66.8
Government money market accounts	.1	-	.1	59.0	59.1	59.1
Investments:						
Commercial paper	73.9	12.0	9.9	-	95.7	95.7
Short-term notes	-	-	97.2	72.9	170.1	170.1
Repurchase agreements	1.6	-	302.5	-	304.1	304.1
Government securities	1,056.7	-	46.6	-	1,103.2	1,103.2
Insured mortgage backed securities	134.9	-	42.6	-	177.5	177.5
Government backed securities	-	93.9	247.4	-	341.2	341.2
Investment agreements	-	-	-	116.6	116.6	116.6
Corporate bonds and notes	250.2	-	61.3	-	311.5	311.5
Preferred stock	-	-	-	.9	.9	.9
Equities	1.9	.1	3.5	42.4	48.0	48.6
Real estate	-	.1	-	.6	.7	.7
Venture capital and leveraged buyouts	-	-	-	18.5	18.5	18.5
Government money market funds	-	-	-	24.4	24.4	24.4
Mutual funds	-	33.6	-	149.2	182.8	179.2
Guaranteed investment contracts	-	-	8.1	757.5	765.7	765.7
Pooled investment funds	-	-	-	681.2	681.2	681.1
Other investments	-	-	13.7	17.3	31.0	31.0
Total Investments	<u>\$ 1,537.3</u>	<u>\$ 139.7</u>	<u>\$ 879.7</u>	<u>\$ 1,942.6</u>	4,499.2	<u>\$ 4,496.0</u>
Less Investments Reported as						
"Cash" on the Statement of Net Assets					(507.6)	
Total Investments					<u>\$ 3,988.4</u>	
<u>As Reported on the Statement of Net Assets</u>						
Current investments					\$ 815.9	
Noncurrent restricted investments					1,170.0	
Noncurrent investments					2,002.6	
Total Investments					<u>\$ 3,988.4</u>	

(1) The deposits classified as investments were reflected in the accounts of the banks in amounts equal to their carrying value and are categorized using the deposit risk category definitions.

NOTE 9 – CAPITAL ASSETS

A. Primary Government

Summary of Significant Accounting Policies

Methods used to value capital assets

Capital assets, which include property, plant, equipment, and infrastructure items (e.g. roads, bridges, ramps, and similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Capitalization policies

All land and non-depreciable land improvements are capitalized, regardless of cost. Equipment is capitalized when the cost of individual items exceed \$5 thousand, and all other capital assets are capitalized when the cost of individual items or projects exceed \$100 thousand.

The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Items not capitalized and depreciated

The State possesses certain capital assets that have not been capitalized and depreciated, because the assets cannot be reasonably valued and/or the assets have inexhaustible useful lives. These assets include works of art and historical treasures, such as statues; monuments; historical documents; paintings; forts and lighthouses; rare library books; miscellaneous capitol-related artifacts and furnishings; and the like.

Depreciation and useful lives

Applicable capital assets are depreciated using the straight-line method, with a half-year's depreciation charged in the year of acquisition and in the year of disposal. Agencies assigned useful lives that were most suitable for the particular assets. Estimated useful lives generally were assigned as follows:

<u>Asset</u>	<u>Years</u>
Equipment	2-25
Buildings	3-50
Infrastructure	15-40
Land Improvements	10-40

Modified approach for infrastructure

The State has elected to use the "modified approach" to account for certain infrastructure assets, as provided in GASB Statement No. 34. Under this process, the State does not record depreciation expense nor are amounts capitalized in connection with improvements to these assets, unless the improvements expand the capacity or efficiency of an asset. Utilization of this approach requires the State to: 1) commit to maintaining and preserving affected assets at or above a condition level established by the State, 2) maintain an inventory of the assets and perform periodic condition assessments to ensure that the condition level is being maintained, and 3) make annual estimates of the amounts that must be expended to maintain and preserve assets at the predetermined condition levels.

Roads and bridges maintained by the Department of Transportation are accounted for using the modified approach.

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Capital asset activities for the fiscal year ended September 30, 2002 were as follows (in millions):

Governmental Activities	Beginning Balance	Additions	Deletions	Adjustments and Reclass- ifications	Ending Balance
Capital assets, not being depreciated:					
Land	\$ 3,015.3	\$ 84.8	\$ (2.4)	\$ (15.3)	\$ 3,082.4
Land improvements	8.4	.2	-	(3.5)	5.1
Construction in progress	940.3	729.7	(321.4)	(134.0)	1,214.6
Infrastructure	11,594.9	144.7	(252.1)	-	11,487.5
Mineral rights	18.9	-	-	-	18.9
Total capital assets, not being depreciated	15,577.9	959.4	(576.0)	(152.8)	15,808.5
Capital assets, being depreciated:					
Land improvements	72.3	5.0	-	15.6	92.9
Equipment and vehicles	624.9	159.6	(54.4)	(62.1)	668.1
Buildings	2,628.4	397.6	(115.9)	63.6	2,973.8
Infrastructure	498.3	22.2	(3.0)	77.3	594.7
Total capital assets, being depreciated	3,823.9	584.4	(173.3)	94.4	4,329.5
Less accumulated depreciation for:					
Land improvements	(24.5)	(2.7)	-	(2.6)	(29.7)
Equipment and vehicles	(430.1)	(121.4)	33.0	52.8	(465.8)
Buildings	(913.9)	(82.5)	24.8	(4.9)	(976.5)
Infrastructure	(282.8)	(21.9)	2.5	(13.9)	(316.1)
Total accumulated depreciation	(1,651.3)	(228.5)	60.5	31.3	(1,788.1)
Total capital assets, being depreciated, net	2,172.6	355.9	(112.8)	125.7	2,541.4
Governmental activity capital assets, net	\$ 17,750.5	\$ 1,315.3	\$ (688.8)	\$ (27.1)	\$ 18,349.9
Business-type Activities	Beginning Balance	Additions	Deletions	Adjustments and Reclas- sifications	Ending Balance
Capital assets, being depreciated:					
Buildings	\$ 1.5	\$.1	\$ -	\$ -	\$ 1.6
Equipment	1.9	.3	(.1)	-	2.1
Total capital assets, being depreciated	3.4	.4	(.1)	-	3.7
Less accumulated depreciation for:					
Buildings	(1.5)	-	-	-	(1.6)
Equipment	(1.6)	(.1)	-	-	(1.7)
Total accumulated depreciation	(3.1)	(.2)	-	-	(3.3)
Total capital assets, being depreciated, net	.3	.2	-	-	.4
Business-type activity capital assets, net	\$.3	\$.2	\$ (.1)	\$ -	\$.4

Michigan
Notes to the Financial Statements

Depreciation expense was charged to functions of the primary government as follows:

	<u>Amount</u>
Governmental Activities:	
General Government	\$ 15.5
Education	.2
Family Independence Services	11.6
Public Safety and Corrections	39.5
Conservation, Environment, Recreation, and Agriculture	11.5
Labor, Commerce, and Regulatory	8.0
Health Services	7.9
Transportation	38.9
Depreciation on capital assets held by the State's internal service funds is charged to the various functions based on their use of the assets.	<u>44.7</u>
Total Depreciation Expense – Governmental Activities	<u>\$ 177.9</u>
Business-type Activities:	
Enterprise	<u>.2</u>
Total Depreciation Expense – Business-type Activities	<u>\$.2</u>

B. Discretely Presented Component Units

The following table summarizes net capital assets reported by the discretely presented component units (in millions):

	<u>Amount</u>
State Universities:	
Land and other non-depreciable assets	\$ 80.5
Buildings, equipment, and other depreciable assets	3,315.8
Infrastructure	64.2
Construction in progress	<u>284.6</u>
Total	3,745.2
Less accumulated depreciation	<u>(1,312.7)</u>
Capital Assets, net – State Universities	2,432.5
Capital Assets, net – Authorities	<u>134.1</u>
Capital Assets, Total – Discretely Presented Component Units	<u>\$ 2,566.6</u>

NOTE 10 – PENSION BENEFITS AND OTHER POSTEMPLOYMENT BENEFITS

A. Defined Benefit Pension Plans

The State of Michigan administers the following defined benefit pension plans:

Legislative Retirement System (LRS) - single employer
State Police Retirement System (SPRS) - single employer
State Employees' Retirement System (SERS) - single employer
Public School Employees' Retirement System (PSERS) - cost sharing multi-employer
Judges' Retirement System (JRS) - cost sharing multi-employer
Military Retirement Plan (MRP) - single employer

Each plan provides retirement, disability, death benefits, and annual cost-of-living adjustments to plan members. Each plan, except MRP, is accounted for in a separate pension trust fund and also issues a publicly available financial report that includes financial statements and required supplementary information for that plan. Those reports, except LRS, may be obtained by writing to the Department of Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-6262. The LRS report may be obtained by writing to the Michigan Legislative Retirement System, House Office Building, Suite S0927, P.O. Box 30014, Lansing, MI 48909 or by calling (517) 373-0575.

As mandated by legislation, all new State of Michigan employees hired on or after March 31, 1997, are members of the defined contribution retirement plan as opposed to the LRS, SERS and JRS defined benefit plans. Employees hired before that date were given the option of remaining in the defined benefit plan or transferring to the defined contribution plan. The decision is irrevocable and transfers were completed by September 30, 1998. This was a one-time opportunity. With the passage of the legislation permitting the transfer, the LRS, SERS and JRS defined benefit plans became closed systems.

Plan Membership Data	LRS	SPRS	SERS	PSERS	JRS	MRP
Current active:						
Vested	52	1,058	35,062	120,787	270	637
Nonvested	1	990	8,002	205,751	97	9,205
Retirees & beneficiaries receiving benefits	247	2,462	39,666	135,277	535	2,156
Terminated members with vested deferred benefits	72	14	7,917	14,403	16	965

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSETS MATTERS

Basis of Accounting

The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Methods Used to Value Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price. The fair value of real estate investments is based on independent appraisals. Investments that do not have an established market are reported at estimated fair value.

Significant Investments

No investment of any of the pension plans comprises 5% or more of the net assets available for benefits. There are no significant investments made in securities issued by the State, nor are there any loans made from the pension plans to the State. Additional disclosures concerning investments are provided in Note 8 and, concerning State Treasurer's Common Cash, in Note 5.

FUNDING POLICY

The Legislature establishes the extent to which the employer and employees are required to make contributions and establishes the benefit provisions for each plan. Actual total contributions for pensions met or exceeded the contributions required by state law.

The Public School Employees' Retirement System (PSERS) is a cost-sharing, multiple-employer, State-wide defined benefit retirement system. Statute requires a reconciliation of required contributions and actual contributions in the PSERS. Public Act 158 of 1992 provides that any overage or shortage must be paid in installments over five years.

The contributions for judges in the Judges' Retirement System are non-employer contributions to cost-sharing multiple-employer defined benefit pension systems.

The contributions to all other systems are employer contributions to single-employer defined benefit systems. However, the State does not make actuarially computed contributions to the Military Retirement Plan (MRP). MRP benefits, which are funded on the pay-as-you-go basis, are paid from the General Fund.

Effective in fiscal year 2000-2001, SPRS, SERS, and PSERS use the valuation for the previous fiscal year for their respective reports. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement No. 25. Consistent with this approach the most recent actuarial valuation was performed as of September 30, 2001.

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Notes to the Financial Statements

ANNUAL PENSION COST AND OTHER RELATED INFORMATION

*Current year contribution rates, annual pension cost, and related information for the current year for the State's single employer defined benefit plans are as follows:

	<u>LRS</u>	<u>SPRS</u>	<u>SERS</u>	<u>MRP</u>
Required contribution rates:				
State	-	18.56%	5.00%	-**
Plan Members	***	-	-	-
(Amounts are in millions)				
Annual Pension Cost and Net Pension Obligation:				
Annual required contribution	\$ -	\$ 22.04	\$ 111.55	\$ 2.99
Interest on net pension asset	(.15)	1.04	(8.13)	.52
Adjustment to annual required contribution	.28	(.67)	8.39	(.54)
Annual pension cost	.12	22.41	111.81	2.97
Contributions made	-	22.46	87.49	2.41
Transfer to Health Advance Funding Subaccount****	-	-	(87.49)	-
Change in net pension asset/obligation	.12	(.05)	111.81	.56
Net pension (asset) obligation at beginning of fiscal year	(2.21)	13.06	(101.66)	6.48
Net pension (asset) obligation at end of fiscal year	<u>\$ (2.09)</u>	<u>\$ 13.01</u>	<u>\$ 10.14</u>	<u>\$ 7.04</u>
Significant Actuarial Assumptions used include:				
Latest actuarial valuation date	9/30/02	9/30/01	9/30/01	9/30/01
Actuarial cost method	Entry Age	Entry Age	Entry Age	Entry Age
Amortization method	Level percent of payroll open	Level percent closed	Level percent of payroll closed	Level dollar closed
Remaining amortization period	12 years	35 years	35 years	35 years
Asset valuation method	5-year smoothed market	5-year smoothed market	5-year smoothed market	None, Unfunded plan
Actuarial assumption:				
Investment rate of return	7%	8%	8%	8%
Projected salary increases	4%	4.7 - 84%	4 - 16%	4%
Includes inflation at	4%	4%	4%	4%
Cost-of-living adjustments	4% annual compounded (not compounded for legislators elected after 1/1/95)	2% annual non-compounded with maximum annual increase \$500	3% annual non-compounded with maximum annual increase \$300	4% for special duty retirees

*For MRP, information provided is based on most recent biennial actuarial valuation.

**For MRP, there is no underlying payroll of participants. Except for five special duty members, retirees receive \$600 in annual pension benefits. Accordingly, the annual required contribution from the State is determined as a dollar amount, not as a percentage of payroll.

***For participants prior to January 1, 1995, the required contribution rate is 9.0%. For participants after January 1, 1995, the required contribution rate is 7.0%. All contributions are made to the Health Insurance Fund, as described in Section C.

****Transferred pursuant to P.A. 93 of 2002.

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Notes to the Financial Statements

Contribution rates for the current year for the State's cost-sharing multiple-employer defined benefit plans are as follows:

	<u>PSERS</u>	<u>JRS</u>
Required contribution rates:		
State	N/A	**
Plan Members	3.9*	5.93
Number of participating employers	716	172

N/A - Not available

*For those members who elect to participate in the "Member Investment Plan," the rate is 3.9%. Members hired after December 31, 1989, are required to participate in the "Member Investment Plan," and their contribution rate varies from 3.0 to 4.3% as salary increases.

**The State is required to contribute annually the greater of 3.5% of the aggregate annual compensation of State paid based salaries or required amount. However, the plan in the current year is fully funded; therefore, no contribution is required.

THREE YEAR HISTORICAL TREND INFORMATION

The following table provides a schedule of funding progress for the State's defined benefit plans:

(Amounts in millions)		(a)	(b)	(b-a)	(a/b)	(c)	((b-a)/c)
	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded (Overfunded) AAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
LRS							
	9/30/02	\$ 167.2	\$ 143.9	\$ (23.3)	116.2%	\$ 4.3	(541.9)%
	9/30/01	168.4	138.6	(29.8)	121.5	4.3	(693.0)
	9/30/00	160.3	128.5	(31.8)	124.7	4.3	(739.5)
SPRS**							
	9/30/01	1,148.6	1,073.6	(75.0)	107.0	118.8	(63.1)
	9/30/00	1,113.1	1,040.7	(72.4)	107.0	116.6	(62.1)
	9/30/99	1,036.8	1,006.5	(30.3)	103.0	116.9	(25.9)
SERS**							
	9/30/01	10,632.7	9,878.2	(754.5)	107.6	2,230.6	(33.8)
	9/30/00	10,336.8	9,473.8	(863.0)	109.1	2,253.8	(38.3)
	9/30/99	9,648.3	9,028.6	(619.7)	106.8	2,213.8	(28.0)
PSERS**							
	9/30/01	38,399.0	39,774.0	1,375.0	96.5	9,264.0	14.8
	9/30/00	36,893.0	37,139.0	246.0	99.3	8,985.0	2.7
	9/30/99	34,095.0	34,348.0	253.0	99.3	8,644.0	2.9
JRS							
	9/30/02	291.7	229.2	(62.5)	127.3	42.4	(147.3)
	9/30/01	291.0	224.7	(66.3)	129.5	42.5	(155.7)
	9/30/00	274.8	204.2	(70.6)	134.6	37.0	(190.7)
MRP*							
	9/30/01	-	34.4	34.4	-	.5	7,284.7
	9/30/99	-	33.5	33.5	-	.5	6,771.4
	9/30/97	-	30.3	30.3	-	.4	7,575.0

*Actuarial valuation performed biennially.

**The most recent actuarial valuation was performed as of September 30, 2001.

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Notes to the Financial Statements

The following table provides a schedule of annual pension cost and net pension obligation for the State's single employer defined benefit plans (amounts in millions):

	Year	Annual Cost (APC)	Percentage Contributed	Net Pension Obligation (Asset)
LRS				
	1999-00	.1	-	(2.3)
	2000-01	.1	-	(2.2)
	2001-02	.1	-	(2.1)
SPRS				
	1999-00	24.6	89.8	14.7
	2000-01	22.4	107.3	13.1
	2001-02	22.4	100.2	13.0
SERS				
	1999-00	121.1	100.6	(92.6)
	2000-01	103.2	108.8	(101.7)
	2001-02	111.8	-	10.1
MRP				
	1999-00	3.0	74.8	5.8
	2000-01	3.0	76.5	6.5
	2001-02	3.0	81.1	7.0

The following table provides a schedule of annual required contributions for the State's cost-sharing multiple-employer defined benefit plans (amounts in millions):

	Fiscal Year	Annual Required Contribution (ARC)	Percentage of ARC Contributed
PSERS			
	1999-00	572.6	114.4
	2000-01	582.4	108.2
	2001-02	669.0	90.3
JRS			
	1999-00	-	-
	2000-01	-	-
	2001-02	-	-

REQUIRED SUPPLEMENTARY INFORMATION

GASB Statement No. 25 requires the disclosure of certain six-year historical trend information. This information, except for MRP, is available from the separately issued financial reports of the retirement systems. For MRP, this information is presented below.

Trend information is intended to help users assess the funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

Schedule of funding progress for MRP

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b)-(a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
9/30/97	-	30.3	30.3	-	.4	7,575.0
9/30/99	-	33.5	33.5	-	.5	6,771.4
9/30/01	-	34.4	34.4	-	.5	7,284.7

Actuarial valuation performed biennially; plans with biennial valuations need not present duplicate information for the intervening years.

Schedule of Employer Contributions for MRP:

Year ended September 30	Annual required contribution	Percentage contributed
2002	3.0	80.6
2001	3.0	76.1
2000	3.0	74.6
1999	2.5	84.7
1998	2.5	82.3
1997	2.3	85.0

Actuarial information for MRP is provided in the annual pension cost and other related information section.

B. Defined Contribution Pension Plans

State Employees' Defined Contribution Retirement Plan

The State Employees' Defined Contribution Retirement Plan (Plan) was established to provide benefits at retirement to employees of the State who were hired after March 31, 1997, and to those members of the State Employees' Retirement (defined benefit) System, Judges' Retirement System, and Legislative Retirement System who elected to transfer to this plan. The Plan is administered by the Department of Management and Budget. The State is required to contribute 4% of annual covered payroll. The State is also required to match employee contributions up to 3% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Legislature. Employer contributions to the plan for the year totaled \$43.5 million. Participant contributions to the plan were \$17.5 million. The reports may be obtained by writing to the Department of Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-6262.

The following investments represent 5% or more of net plan assets at September 30, 2002: SSGA Stable Value GIC Fund, \$43.9 million; Yield Enhanced Short-Term Fund, \$92.1 million; SSGA S&P 500 Index Fund, \$18.3 million; Dodge & Cox Stock Fund, \$22.7 million; Fidelity Magellan Fund, \$24.5 million; Putnam Voyager Fund, \$16.8 million.

Effective September 30, 2000, the assets and coverage of members of the Michigan Judges' Retirement System were transferred to the State Employees' Defined Contribution Retirement Plan.

Component Units

In addition to the Public School Employees' Retirement System (PSERS), the State university component units participate in the Teachers' Insurance and Annuity Association and College Retirement Equities Fund (TIAA-CREF). The TIAA-CREF is a defined contribution multiple-employer pension plan. The State university component units are required to contribute between

4% and 15% of annual covered payroll, as determined by each institution's employment agreements. The total contribution to the TIAA-CREF for all State university component units was \$62.7 million for the year ending June 30, 2002.

Additional plan information may be found in the separately issued financial reports of the State university component units.

C. Other Postemployment Benefits

In addition to the pension benefits previously described in this Note, State statutes require that the State provide certain postemployment benefits (OPEB) to many of its retired employees. Health, dental, and vision benefits as well as life insurance coverage are provided to retirees of all pension plans except MRP. These benefits are funded on a pay-as-you-go basis, except for LRS life insurance coverage, as explained below.

The LRS life insurance benefits are paid on an advance-funded basis. The actuarial cost method and actuarial assumptions are the same as for the pension plan, as discussed in Section A. At September 30, 2002, the actuarial accrued liability for life insurance premiums was \$8.1 million with net assets available for benefits of \$11.2 million. The expense for life insurance premiums was \$.3 million in fiscal year 2001-2002.

The net assets available for benefits relate to residual balances from funding provided in prior fiscal years. Public Act 93 of 2002 created a health advance funding subaccount within the State Employees' Retirement System as a means to begin prefunding, on an actuarial basis, health benefits for participants in the System. During fiscal year 2001-2002, pension contributions of \$87.5 million were transferred to the subaccount pursuant to this legislation.

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Notes to the Financial Statements

Following is a brief summary of the other postemployment benefits as of September 30, 2002:

	<u>LRS</u>	<u>SPRS</u>	<u>SERS</u>	<u>JRS</u>	<u>PSERS</u>	<u>TOTAL</u>
Participants eligible for benefits	326	2,462	39,689	535	135,277	178,266
Contribution rates for current employees (% of payroll)	None	None	None	1.5%	None	
Percentage of pre-Medicare premiums paid by participants	None	5%	5%	5%	10%*	
Expense for year (in millions)	\$ 3.1	\$ 26.0	\$ 279.0	\$.5	\$ 513.2	\$ 821.8
Net assets available for benefits (in millions)	6.6	(1.9)	97.4	(.6)	319.8	421.4

*The schools that employ the plan's members pay the employer share of health costs. PSERS retirees pay the same share of health care costs required from Social Security retirees for part B Medicare coverage until Medicare coverage begins at age 65.

Dental, vision, and hearing benefits are also extended to all retirees and their beneficiaries, for which retirees pay 10% of the health premiums.

NOTE 11 – LEASES

Accounting Policy

The State leases various assets under noncancelable leasing arrangements. Leases that constitute rental agreements are classified as operating leases; the resulting expenditures are recognized as incurred over the lease term. Leases that are comparable to purchases are classified as capital leases.

In the government-wide and proprietary fund statements, assets and liabilities resulting from capital leases are recorded at lease inception. The principal portion of lease payments reduces the liability; the interest portion is expensed.

For capital leases in governmental funds, other financing sources and expenditures are recorded at lease inception. Lease payments are recorded as debt service expenditures. (As explained in Note 3, for budgetary purposes, lease payments are only reported as expenditures when paid.)

Most leases have cancellation clauses with 1 to 6 month notice requirements in the event that funding is not available. For reporting purposes, such cancellation clauses are not considered in the determination of whether a lease is cancelable, because the likelihood that they will be exercised is considered remote. Some lease agreements include renewal or purchase options. The effect of such options is reflected in the minimum lease payments only if it is considered reasonably assured that an option will be exercised. Some lease agreements include escalation clauses or other contingent rentals.

The State has entered into a few installment purchase agreements. Because the amounts involved are immaterial, and the accounting treatment is similar, such agreements are reported together with capital leases.

Leases that exist between the State and the State Building Authority (SBA, a blended component unit) are not recorded as leases in this report. In their separately issued financial statements, SBA records a lease receivable from the State. Although payables and receivables technically exist between these parties, when combined for government-wide reporting, they are eliminated. A long-term liability exists on the government-wide statements for the bonds issued by SBA to construct the assets associated with the leases. Future payments to SBA are, therefore, not included in the schedules of lease commitments below. Note 12 provides information on the amount of the Authority's bonds outstanding and a schedule of debt service requirements.

A. Primary Government – Governmental Activities

Rental expenditures incurred under operating leases totaled \$90.3 million during the fiscal year. Payments for capital lease principal, interest, and executory costs totaled \$36.2 million, \$31.5 million, and \$15.1 million, respectively.

A summary of the operating and noncancelable capital lease commitments to maturity follows (in millions).

Capital Leases					
Year Ended September 30	Operating Leases	Principal	Interest	Executory Costs	Total
2003	\$ 38.2	\$ 38.2	\$ 42.1	\$ 20.0	\$ 100.3
2004	31.7	37.0	38.8	19.7	95.5
2005	25.6	29.2	35.8	19.2	84.2
2006	17.8	25.1	33.0	18.2	76.3
2007	10.3	22.6	30.3	16.6	69.4
2008-2012	16.0	98.0	117.4	69.7	285.1
2013-2017	1.1	99.8	70.7	54.6	225.0
2018-2022	-	72.1	23.3	26.2	121.6
Thereafter	-	39.5	5.4	8.0	52.9
Total	\$ 140.6	\$ 461.4	\$ 396.8	\$ 252.2	\$ 1,110.4

Michigan
Notes to the Financial Statements

The above capital leases relate to governmental activities which include the General Fund, special revenue funds, and the internal service funds. A liability of \$461.4 million has been recorded in the government-wide statements for the capital lease principal. The historical cost of assets acquired under capital leases and included in capital assets on the government-wide statements at September 30 follows (in millions):

Land	\$ 70.0
Buildings	449.3
Equipment	62.0
Total	581.3
Accumulated Depreciation	(149.1)
Net Land, Buildings, and Equipment	<u>\$ 432.1</u>

B. Primary Government – Business-Type Activities

Rental expense incurred under operating leases totaled \$2 million during the fiscal year. There were no capital lease obligations.

A summary of operating lease commitments to maturity follows (in millions):

Year Ended September 30	Operating Leases
2003	\$.1
2004	.1
	<u>\$.3</u>

C. Discretely Presented Component Units

Operating lease commitments for universities and authorities totaled \$12.4 million. Total capital lease obligations were \$20.3 million, \$13.8 million, and \$0 for principal, interest, and executory costs, respectively.

NOTE 12 – BONDS AND NOTES PAYABLE – PRIMARY GOVERNMENT

A. General Information

General Obligation Bonds and Notes

Article 9, Section 15, of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In addition, debt may be incurred without voter approval for the purpose of providing loans to school districts. General obligation notes to provide temporary financing for such loans are recorded as liabilities in the School Bond Loan Fund, a special revenue fund. No such borrowing occurred in fiscal year 2001-2002. General Fund appropriations are made to finance debt principal and interest requirements for all general obligation issues. General obligation bonds are backed by the full faith and credit of the State.

The State Constitution provides that the Legislature may also authorize the issuance of general obligation short-term notes, the principal amount of which may not exceed 15% of undedicated revenues received in the preceding year. The State Constitution also provides that such notes must be repaid within the fiscal year of the borrowing. No such borrowing occurred in fiscal year 2001-2002.

Revenue Dedicated Bonds and Notes

Long-term bonds have been issued periodically for specific purposes, with the stipulation that financing of debt requirements is to come strictly from designated revenue sources. The transportation related debt is payable solely out of funds restricted for transportation purposes by Article 9, Section 9, of the State Constitution. The State's general credit does not support such issues.

The Michigan Underground Storage Tank Financial Assurance Finance Authority issued revenue bonds to provide financing for the activities of the Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA). The bonds and notes are a limited obligation of the Authority payable solely from dedicated revenues and do not represent a general obligation of the finance authority or the State.

Revenue bonds have been issued by the State Building Authority (SBA) to acquire and/or construct various facilities for use by the State or institutions of higher education. Revenue bonds have also been issued to finance equipment capital lease refinancings and acquisitions. The \$255.5 million of commercial paper notes outstanding at year-end are not recorded as liabilities in the Authority's statements, but are included in the "Changes in Bonds and Notes Payable" schedule presented later in this Note.

In addition to the \$400.0 million of grant anticipation notes issued in fiscal year 2000-2001, the Department of Transportation issued \$200.0 million of grant anticipation notes in fiscal year 2001-2002. The notes have variable rates that may bear interest at a daily interest rate, a weekly rate, note interest term rate, long-term interest rate, or an ARS interest rate.

The notes are issued in accordance with the authorization provided in P.A. 51 of 1951, as amended. The proceeds of the sale of the notes, together with investment earnings on the proceeds and other available monies, will be used to pay a portion of the costs to complete the Build Michigan II highway program, to pay capitalized interest on the notes, and to pay note issuance costs.

The principal and interest on the notes are payable solely from and are secured by an irrevocable pledge of the State share of all federal grants received each year under the Federal-Aid Highway Program. Payment of the principal and interest on the notes from the State share shall be subject to an appropriation each year by the Legislature in an amount sufficient to make the payments. As of September 30, 2002, there were no principal payments made on the notes. The amount outstanding at September 30, 2002, \$600.0 million, is not disclosed in the table below. The notes issued in fiscal year 2000-2001 mature in 2008 and the notes issued in fiscal year 2001-2002 mature in 2009.

Note 13 provides disclosures regarding the bonds and notes payable of the discretely presented component units.

Michigan
Notes to the Financial Statements

Bonds Issued and Outstanding

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:			FISCAL YEAR MATURITIES		AVERAGE INTEREST RATE
	AMOUNTS ISSUED	OUTSTANDING 9/30/2002	FIRST YEAR	LAST YEAR	RATE PERCENTAGE
GENERAL OBLIGATION BONDED DEBT					
General Obligation Refunding Debt:					
Series 2001 (Refunding)	\$ 183.3	\$ 183.2	2002	2016	4.76
Series 2002 (Refunding)	300.7	300.7	2004	2017	4.40
Recreation and Environmental Protection:					
Series 1989 (1)	75.0	27.8	1991	2012	6.92
Series 1992 (1)	246.3	90.5	1994	2013	6.15
College Savings Bonds - Series 1992 Mini-bonds (1)	.5	.9	2012	2012	6.50
Series 1992 A (1)(2)	13.9	8.7	1994	2012	6.17
Series 1993 (1)(2)	16.7	11.9	1995	2013	5.00
Series 1995 (1)	234.3	94.6	1997	2020	5.28
Series 1998 (1)	90.0	19.9	1999	2009	4.80
Series 1999 A (3)	81.8	22.4	2004	2010	5.57
Series 1999 B (3)	15.1	5.4	2001	2003	6.75
Series 2000 (1)	60.0	18.9	2002	2011	5.22
Series 2001 (3)	56.8	56.8	2004	2020	4.82
School Loan Bonds:					
Series 1995	180.0	39.6	1997	2007	5.47
Series 1998	160.0	78.9	2001	2012	4.86
Series 2001 A	81.3	81.3	2005	2021	3.50
Series 2001 B	1.2	1.2	2021	2021	3.50
Series 2001 C	45.9	45.9	2019	2021	3.50
Series 2002 A	50.6	31.0	2005	2019	3.50
TOTAL GENERAL OBLIGATION BONDED DEBT	1,893.3	1,119.6			
REVENUE DEDICATED BONDED DEBT					
<u>MUSTFA Related:</u>					
Tax Dedicated Bonds:					
1996 - Revenue Bonds - Series I	216.6	137.5	1997	2010	5.67
<u>State Park Related:</u>					
2002 - Gross revenue Bonds	15.5	15.5	2004	2023	3.58
TOTAL REVENUE DEDICATED BONDED DEBT - MUSTFA AND STATE PARK RELATED	232.1	153.0			
<u>Transportation Related:</u>					
Tax Dedicated Bonds:					
Michigan Comprehensive Transportation:					
Series 1996 (Series A Refunding)	22.7	22.3	1998	2014	5.42
Series 1998 (Series A Refunding)	38.6	38.6	2005	2011	4.66
Series 2001 (Series A Refunding)	27.8	27.8	2008	2022	5.01
Series 2002 (Series A Refunding)	89.6	89.6	2003	2011	5.06
Series 2002 (Series B)	82.3	82.3	2004	2022	5.13
State Trunkline Fund Bonds:					
Series 1989 (Series A)	135.8	26.7	1994	2009	6.97
Series 1992 (Series A and Series B Refunding)	353.2	76.0	1999	2013	6.16
Series 1994 (Series A and Series B Refunding)	241.0	18.6	1996	2006	5.53
Series 1996 (Series A)	54.5	6.6	1998	2008	5.71
Series 1998 (Series A)	377.9	377.9	2006	2027	5.09
Series 2001 (Series A)	308.2	308.2	2003	2031	5.27
Series 2002 (Refunding)	97.9	97.9	2004	2022	4.71
TOTAL REVENUE DEDICATED BONDED DEBT - TRANSPORTATION RELATED	1,829.4	1,172.6			
<u>State Building Authority:</u>					
1993 Revenue Bonds Series I (Refunding)	491.5	254.6	1994	2016	4.58
1994 Series I Bonds	39.8	23.4	1995	2012	5.07
1994 Series II Bonds	29.1	19.0	1996	2011	4.62
1996 Series I Bonds	109.9	68.6	1997	2010	5.04
1997 Series I Bonds	144.8	101.0	1997	2010	5.18
1997 Series A Bonds	34.3	19.0	1997	2006	4.76

Michigan
Notes to the Financial Statements

			FISCAL YEAR MATURITIES		AVERAGE INTEREST RATE
	AMOUNTS ISSUED	OUTSTANDING 9/30/2002	FIRST YEAR	LAST YEAR	PERCENTAGE
<u>State Building Authority (continued):</u>					
1997 Series II Bonds	371.9	305.0	1997	2014	5.53
1998 Series I Bonds	109.5	92.8	1998	2014	4.84
1998 Series I Bonds (Refunding)	330.4	305.2	1999	2021	4.75
1999 Series I Bonds	85.7	75.7	1999	2016	4.54
2000 Revenue Bonds	45.8	42.6	2000	2012	5.63
2000 Series I Bonds	147.9	144.2	2000	2022	5.24
2001 Series I Bonds	121.7	119.2	2002	2019	5.28
2001 Revenue Bonds	58.2	56.8	2002	2014	5.13
2001 Series I Bonds (Refunding)	419.7	419.5	2003	2026	5.31
2001 Series II Bonds	170.1	170.1	2003	2020	5.28
2002 Series I Multi-Modal Bonds	215.2	215.2	2003	2038	1.65
2002 Series II Multi-Modal Bonds	150.3	150.3	2004	2037	1.40
TOTAL STATE BUILDING AUTHORITY BONDED DEBT	3,075.7	2,582.1			
TOTAL REVENUE DEDICATED BONDED DEBT	5,137.2	3,907.7			
TOTAL GENERAL OBLIGATION AND REVENUE DEDICATED BONDED DEBT	\$ 7,030.6	\$ 5,027.2			

(1) Public Act 327 of 1988 and P.A. 451 of 1994 authorized the issuance of bonds totaling \$800.0 million. As of September 30, 2002, \$736.6 million of such bonds had been issued, leaving remaining authorization of \$123.4 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed.

(2) The \$13.9 million Series 1992A and the \$16.7 million Series 1993, Recreation and Environmental Protection General Obligation Bonds, were used to provide a contribution of capital to the Michigan Municipal Bond Authority (a discretely presented component unit). An outside trustee for the Authority is holding

the bonds as an investment of the Authority; no immediate cash proceeds were provided. The trustee receives the debt service payments on the bonds, which are negotiable instruments held to subsidize water pollution control financing provided by the Authority.

(3) Public Act 284 of 1998 authorized the issuance of bonds totaling \$675.0 million. As of September 30, 2002, \$153.6 million of such bonds had been issued, leaving remaining authorization of \$521.4 million.

Capital Appreciation Bonds

Capital appreciation and convertible capital appreciation bonds are recorded in the preceding table and Section B at their

accrued year-end book value. The table that follows summarizes capital appreciation bonds (in millions):

			FISCAL YEAR MATURITIES	
	ACCREDITED BOOK VALUE	ULTIMATE MATURITY VALUE	FIRST YEAR	LAST YEAR
State Building Authority:				
1994 Series II	\$ 17.8	\$ 21.4	2000	2012
1997 Series II	28.6	40.5	2001	2012
General Obligation Bonds:				
Series 1989	31.3	41.0	1999	2012
Series 1992	19.4	27.2	1994	2012
College Savings Bonds - Series 1992 Mini-bonds	.9	1.8	2012	2012
Series 1995	20.4	26.3	2001	2010
Revenue Dedicated – Transportation Related:				
State Trunkline - Series 1989 A	26.7	35.7	2004	2009
State Trunkline - Series 1992 A and B	65.0	97.7	2006	2013

Advance Refundings and Defeasances

The State has defeased certain bonds by placing the proceeds of new bonds (i.e., the "refunding" bonds in the table of bonds issued and outstanding) in irrevocable trust to provide for all future debt service on the old bonds. Accordingly, the trust account assets

and the liability for the defeased bonds are not recorded as assets or liabilities in these statements and are not included in the other debt tables in this note.

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Notes to the Financial Statements

The following table summarizes the defeased bonds outstanding at September 30 (in millions):

	AMOUNTS OUTSTANDING
Recreation and Environmental Protection:	
Series 1989	\$ 3.9
Series 1992	88.6
Series 1995	116.1
Series 1998	57.2
Series 1999 A	59.3
Total	<u>\$ 325.2</u>
School Loan Bonds:	
Series 1995	\$ 103.3
Series 1998	69.1
Total	<u>\$ 172.4</u>
State Trunkline Fund Bonds:	
Series 1992 A (partial)	\$ 194.2
Series 1992 B (partial)	83.4
Series 1994 A (partial)	120.3
Series 1996 A (partial)	43.9
Total	<u>\$ 441.9</u>
State Building Authority:	
1982 Series III	\$ 19.3
1988 Series I	1.8
1989 Series I	35.4
1992 Series I	121.7
1992 Series II A	28.1
Total	<u>\$ 206.4</u>

General Obligation

In July of 2002, the State issued \$300.7 million of General Obligation Refunding Bonds Series 2002. The proceeds were used to refund various portions of previously issued bonds that carried higher interest rates.

The State advance refunded these bonds to reduce its total debt service payments over the next 15 years by \$9.6 million and to achieve an economic gain of \$8.8 million.

Revenue Dedicated

In May of 2002, the State issued \$89.6 million of revenue dedicated Comprehensive Transportation Refunding Bonds Series 2002A. The proceeds were used to refund the outstanding amount of the Comprehensive Transportation

Refunding Bonds Series 1992B which carried a higher interest rate.

The State advance refunded these bonds to reduce its total debt service payments over the next 10 years by \$8.0 million and to achieve an economic gain of \$6.7 million.

In August of 2002, the State issued \$97.9 million revenue dedicated State Trunkline Fund Refunding Bonds Series 2002. The proceeds were used to refund various portions of previously issued bonds that carried higher interest rates.

The State advance refunded these bonds to reduce its total debt service payments over the next 20 years by \$10.3 million and to achieve an economic gain of \$7.9 million.

Michigan
Notes to the Financial Statements

Debt Service Requirements

The following table summarizes debt service requirements for outstanding bonds (in millions):

FISCAL YEARS ENDING	GENERAL OBLIGATION		MUSTFA, STATE PARK, AND TRANSPORTATION RELATED		STATE BUILDING AUTHORITY		TOTAL PRINCIPAL AND INTEREST
	PRINCIPAL	INTEREST	PRINCIPAL	INTEREST	PRINCIPAL	INTEREST	INTEREST
2003	\$ 26.8	\$ 51.4	\$ 53.8	\$ 59.8	\$ 142.3	\$ 115.4	\$ 449.6
2004	33.6	50.6	59.7	60.9	139.1	108.7	452.6
2005	57.5	48.8	63.7	58.2	142.7	101.4	472.3
2006	63.5	46.1	66.9	55.4	124.9	94.6	451.4
2007	66.8	43.3	69.6	52.7	129.7	88.3	450.3
2008-2012	382.8	169.5	311.2	219.9	666.4	339.1	2,088.9
2013-2017	372.3	66.9	244.9	161.6	511.7	184.4	1,541.9
2018-2022	128.7	10.5	304.3	90.4	298.0	82.5	914.6
2023-2027	-	-	119.7	33.4	82.3	34.8	270.2
2028-2032	-	-	73.6	8.0	-	28.3	109.8
2033-2037	-	-	-	-	360.5	26.2	386.6
Total	<u>\$ 1,132.2</u>	<u>\$ 487.2</u>	<u>\$ 1,367.3</u>	<u>\$ 800.3</u>	<u>\$ 2,597.6</u>	<u>\$ 1,203.6</u>	<u>\$ 7,588.2</u>

Interest to maturity for the State Building Authority will be significantly smaller than the amount shown in the above table because many of the bonds will be called prior to the final scheduled maturity date. The retirement of these bonds varies from project to project, as each bond issue is related to specific projects and any excess borrowing and accrued investment earnings are restricted to projects and debt service on the related bonds. State Building Authority debt service fund unreserved

fund balances totaled \$274.8 million at year-end. Most of this represents investments related to completed projects that will be used for debt service on the projects' bonds.

Some of the bonds of the State Building Authority carry variable interest rates and interest on these has been projected using an average interest rate.

B. Changes in Bonds and Notes Payable

Changes in bonds and notes payable for the year ended September 30, 2002, are summarized as follows (in millions):

Governmental Activities	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
Bonds Payable:						
General obligation debt	\$ 1,031.8	\$ 459.9	\$ 372.2	\$ 1,119.6	\$ 26.8	\$ 1,092.8
Revenue bonds	1,274.0	291.0	239.4	1,325.5	53.8	1,271.8
State Building Authority	2,159.3	535.6	112.7	2,582.1	142.3	2,439.8
Notes Payable:						
Transportation related	400.0	200.0	-	600.0	-	600.0
Deferred Loss on Refundings:						
General obligation debt	(11.5)	(22.1)	1.2	(32.4)	-	(32.4)
Revenue dedicated debt	(.7)	(5.3)	.1	(5.9)	-	(5.9)
State Building Authority	(8.2)	-	.3	(7.8)	-	(7.8)
Unamortized Premiums:						
General obligation debt	14.0	33.0	1.7	45.4	-	45.4
Revenue dedicated debt	4.5	19.4	.5	23.4	-	23.4
State Building Authority	25.5	11.8	2.0	35.3	-	35.3
Other Debt:						
State Building Authority						
Commercial paper	307.4	2,343.3	2,395.2	255.5	255.5	-
Total bonds and notes payable	<u>\$ 5,196.1</u>	<u>\$ 3,866.6</u>	<u>\$ 3,122.0</u>	<u>\$ 5,940.7</u>	<u>\$ 478.4</u>	<u>\$ 5,462.3</u>

NOTE 13 – BONDS AND NOTES PAYABLE – DISCRETELY PRESENTED COMPONENT UNITS

A. Bonds and Notes Payable

Bonds Payable

Bonds payable of the discretely presented component units are legal obligations of the component units and are not general obligations of the State.

The State universities and the Michigan State Housing Development Authority utilize June 30 fiscal year-ends. The remaining discretely presented component units have September 30 fiscal year-ends.

The following table summarizes debt service requirements of the discretely presented component units as reported in their separately issued financial statements, utilizing their respective fiscal year-end (in millions):

<u>Fiscal Years Ending In</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 407.9	\$ 287.2	\$ 695.1
2004	221.8	290.8	512.6
2005	226.8	284.5	511.3
2006	228.8	272.8	501.6
2007	254.2	258.5	512.7
	<u>1,339.6</u>	<u>1,393.8</u>	<u>2,733.3</u>
2008-2012	1,347.6	1,058.7	2,406.3
2013-2017	1,144.7	733.5	1,878.2
2018-2022	1,159.0	426.0	1,585.1
2023-2027	535.5	203.5	739.0
2028-2032	440.2	90.0	530.2
2033-2037	530.1	33.0	563.1
2038-2043	254.6	134.0	388.5
Total for 5-year column	<u>5,411.7</u>	<u>2,678.7</u>	<u>8,090.4</u>
Total		<u>\$ 4,072.4</u>	<u>\$ 10,823.8</u>
Deferred amount on refunding	(76.7)		
Unamortized discount	(.1)		
Unamortized premium	88.1		
Total principal	<u>\$ 6,762.6</u>		

Included in the table above is \$460.5 million of demand bonds comprised of the Michigan Higher Education Student Loan Authority, \$191.4 million, and the Michigan State Housing Development Authority, \$269.1 million. Defeased bonds outstanding of the Michigan Municipal Bond Authority, and nine of the State universities are not reflected in the table above.

million of bonds have been defeased in substance, leaving a remaining undefeased balance of \$ 334.3 million.

Notes Payable

The Michigan Municipal Bond Authority has short-term notes outstanding of \$703.9 million as of September 30, 2002.

The Michigan Strategic Fund (MSF) issues industrial development revenue bonds (\$5.9 billion for the period January 1, 1979 through September 30, 2002) which are not recorded as liabilities. Total taxable bonds issued by MSF for the period October 1, 1997 through September 30, 2002, was \$14.2 million, which are not recorded as liabilities. These borrowings are, in substance, debts of other entities and financial transactions are handled by outside trustees.

B. Unrecorded Limited Obligation Debt

Certain State financing authorities have issued limited obligation revenue bonds which are not recorded as liabilities in these statements because the borrowings are, in substance, debts of other entities. The State has no obligation for this debt. Typically, these borrowings are repayable only from the repayment of loans, unloaned proceeds and related interest earnings, and any collateral which may be provided.

The Michigan State Hospital Finance Authority (MSHFA) has issued \$4.8 billion of no commitment bonds as of September 30, 2002. Of the above amount, \$938.6 million have been defeased in substance. Economic gains and accounting gains and losses, resulting from substance defeasance, inure to the benefit of the facility for which the bonds were issued, and accordingly are not reflected in the Authority's financial statements.

The Michigan Higher Education Facilities Authority (MHEFA) issues limited obligation bonds to finance loans to private nonprofit institutions of higher education for capital improvements. As of September 30, 2002, MHEFA had bonds outstanding of \$353.7 million. Of the above amount, \$19.4

The Michigan State Housing Development Authority (MSHDA) has been authorized to issue up to \$800 million of limited obligation bonds to finance multi-family housing projects. At June 30, 2002, limited obligation bonds had been issued totaling \$463.4 million, of which eight issues totaling \$77.6 million had been retired.

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Central Michigan University entered into an interest rate exchange agreement for \$22.0 million of the General Revenue Bonds, Series 2002. In accordance with the exchange agreement, the University pays a fixed rate of 4.44% and receives 67% of the LIBOR rate.

Northern Michigan University entered into an interest rate exchange agreement for \$20.0 million of the 2001 General Revenue Bonds. In accordance with the exchange agreement, the University pays a fixed rate of 4.015% and receives 67% of the one month LIBOR rate, adjusted weekly.

NOTE 14 – OTHER LONG-TERM OBLIGATIONS

A. Primary Government

Other Long-Term Obligations

In general, expenditures and fund liabilities are not recorded in governmental funds for long-term obligations until claims, judgments, or amounts owed are "due and payable" at September 30. Expenses and liabilities for material claims and judgment losses are recorded in the government-wide and proprietary fund financial statements when the loss is considered probable.

Capital Leases

This liability is described in more detail in Note 11.

Compensated Absences

This liability is described in Note 1.

Workers' Compensation

The gross amount of workers' compensation liability, \$311.0 million at September 30, 2002, has been recorded at its discounted present value of \$208.8 million, using a discount rate of 8%. The present value of the current portion of this liability is \$46.2 million. The Accident Fund Company billed State agencies for actual workers' compensation claims paid plus administrative fees, totaling \$51.9 million in fiscal year 2001-2002.

Net Pension Obligation

This liability is described in Note 10.

Other Claims & Judgments

The governmental activity estimated liability for other claims and litigation losses, \$364.9 million at September 30, 2002, includes amounts for litigation, such as damages in tort cases and refund

claims in cases involving State taxes, transportation claims, natural resources and environmental quality claims, and other claims, in which it is considered probable that costs will be incurred. Also included is an estimated liability totaling \$4.2 million for arbitrage payable to the federal government for interest earned on bond proceeds. Where a range of potential loss exists, the amount recorded is based upon the expected minimum amount that will be lost if the State does, indeed, lose. The allowance also includes projections for highway related negligence cases based upon historical loss ratios. The State continues to vigorously contest all of these claims and the State may incur no liability in the individual cases involved. Therefore, the allowance for litigation losses may be overstated (to the extent that losses do not occur) or understated (if the State losses exceed the projected minimums which have been recorded). The maximum potential loss on the allowance for estimated litigation losses is not considered reasonably measurable.

The liability recorded for other claims and judgments within business-type activities represents overpayments by employers to the Michigan Unemployment Compensation Fund totaling \$43.6 million.

Durant Settlement

The reported estimated liability for litigation losses includes the Donald Durant, et al v State of Michigan, et al consolidated cases, which totaled \$391.0 million at September 30, 2002. This amount will, over time, be paid to each "non-Durant" school district for its underfunded State mandated program costs if certain requirements are met. See Note 23 for additional disclosure regarding the Durant case and other contingencies.

Changes in Other Long-Term Obligations

Changes in long-term liabilities for the year ended September 30, 2002, are summarized as follows (in millions):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
Governmental Activities						
Other Long-term Obligations:						
Capital lease obligations	\$ 254.8	\$ 256.3	\$ 49.7	\$ 461.4	\$ 38.2	\$ 423.2
Compensated absences	437.7	239.5	259.4	417.8	43.2	374.6
Workers' compensation	199.9	54.0	45.1	208.8	46.2	162.6
Net pension obligations	19.5	10.7	-	30.2	-	30.2
Other claims & judgments	632.5	610.2	877.9	364.9	108.8	256.1
Durant settlement	451.0	-	60.0	391.0	60.0	331.0
Total Governmental Activities	<u>\$ 1,995.4</u>	<u>\$ 1,170.7</u>	<u>\$ 1,292.0</u>	<u>\$ 1,874.1</u>	<u>\$ 296.3</u>	<u>\$ 1,577.7</u>
Business-type Activities						
Other Long-term Obligations:						
Lottery prize awards*	\$ 764.0	\$ -	\$ 80.4	\$ 683.6	\$ 129.1	\$ 554.5
Compensated absences	3.1	1.1	2.0	2.2	.4	1.7
Other claims & judgments	42.0	1.6	-	43.6	-	43.6
Total Business-type Activities	<u>\$ 809.1</u>	<u>\$ 2.7</u>	<u>\$ 82.4</u>	<u>\$ 729.4</u>	<u>\$ 129.5</u>	<u>\$ 599.9</u>

*The amounts due within one year are included with "Accounts payable and other liabilities" on the Statement of Net Assets.

The General Fund, special revenue, and internal service funds in which the leases are recorded will liquidate the capital lease obligations. The compensated absence and workers' compensation liabilities will be liquidated by the applicable governmental and internal service funds that account for the salaries and wages of the related employees. The net pension obligations will be liquidated by the State's governmental and internal service funds that contribute toward the pension funds, based on the statutorily required contribution rates. The School Aid Fund will liquidate the Durant settlement. Other claims and judgments attributable to governmental activities will generally be liquidated by the General Fund and transportation related special revenue funds.

B. Discretely Presented Component Units

Michigan Education Trust (MET)

MET offers contracts which, for actuarially determined amounts, provide future tuition at State institutions of higher education. Contract provisions also allow the benefits to be used at private or out-of-state institutions, with the amount provided being based upon rates charged by the State's public institutions of higher education. The tuition payments are made by MET as a separate legal entity and these contracts are not considered obligations of the State. The Legislature is not obligated to provide appropriations should losses occur. The statutes and contracts provide for refunds to the participants if MET becomes actuarially unsound. Liabilities have been recorded on the statement of net assets for the actuarial present value of future tuition benefit obligations.

The 1988, 1989, and 1990 enrollments are known as Plans B and C. Enrollments after November 1995 are known as Plan D.

The actuarial report on the status of MET Plans B and C, as of September 30, 2002, shows the actuarial present value of future tuition obligations to be \$641.3 million, as compared to the actuarially determined market value of assets available of \$724.9 million. The actuarial assumptions used include: a projected tuition increase rate of 5.80% for the years through 2008 and 7.30% for subsequent years; and a discount rate of 5.27%.

The actuarial report on the status of MET Plan D, as of September 30, 2002, shows the actuarial present value of future tuition obligations to be \$206.4 million, as compared to the actuarially determined market value of assets available of \$193.5 million. The actuarial assumptions used include: a projected tuition increase rate of 5.84% for the years through 2008 and 7.30% for subsequent years; and a discount rate of 7.00%.

On November 8, 1994, the U.S. Court of Appeals for the Sixth Circuit ruled that MET is an integral part of the State of Michigan and, thus, the investment income realized by MET is not currently subject to federal income tax. On August 20, 1996, the Small Business Job Protection Act of 1996 (the "1996 Tax Act") was signed into law which included a provision adding a new section to the Internal Revenue Code of 1986 defining "qualified state tuition programs." A qualified state tuition program is generally exempt from income tax, but is subject to unrelated business income tax. MET has no unrelated business income. Distributions made in excess of contributions (whether to the refund designee, beneficiary, or to a college on behalf of the beneficiary) are taxable income to the beneficiary or the refund designee. The Internal Revenue Service (IRS) was expected to release regulations in 2000, which would have clarified the 1996 federal legislation for qualified state tuition programs. In May 1997, MET submitted a request for ruling to the IRS for verification that MET is in compliance with the 1996 Tax Act. On December 23, 1997, the IRS issued a favorable ruling which confirms that MET is in compliance with the Act.

NOTE 15 – INCOME TAX REFUNDS AND TAX EXPENDITURES

A. Income Tax Credits

The Michigan Income Tax Act provides for several types of tax credits. Some credits are accounted for as revenue reductions for financial reporting purposes while others are reported as expenditures. Revenue reductions are reported for those income tax credits that are limited by the amount of an individual's tax liability before considering such credits. To the extent these nonrefundable credits will generate future year payments, they are accrued as income tax refund liabilities together with estimated overwithholdings.

Expenditures are reported for those credits which can be received even if they exceed the individual's tax liability. For these refundable credits, the substance of the transaction is that the State is making a grant payment using the income tax system as a filing and payment mechanism. The amount of credit received is not a part of the determination of tax liability. The State's property tax, home heating, and senior citizens' prescription drugs credits are the primary credits that fall into this category. Expenditures for these credits are recognized in the year the tax returns are filed and recipients claim the credits.

The following table summarizes the various credits, reported as an expense/expenditure on the "Tax credits" line in the government-wide and fund financial statements (in millions).

Property tax credits:	
General homestead	\$ 301.7
Senior citizens	244.6
Farmland preservation	29.3
Other property tax credits	24.5
Subtotal – property tax credits	<u>600.0</u>
Adoption credit	.8
Home heating (excluding federal share)	.1
Senior citizens' prescription drugs	14.2
Total tax expenditures	<u>\$ 615.1</u>

B. Income Tax Refunds Payable

The \$652.8 million reported as a liability on the "Income tax refunds payable" line in the government-wide and fund financial statements includes: projected refund estimates for overwithholding and tax credits reported as revenue reductions, actual refunds made in October and November, and accruals for known income tax litigation losses.

NOTE 16 – DEFERRED COMPENSATION PLANS

The State offers its employees (excluding university employees) two deferred compensation plans to allow a portion of their salary to be deferred until future years. Executive Order 1999-7 transferred administrative oversight of the plans, labeled 457 and 401k after sections of the Internal Revenue Code, to the Department of Management and Budget. Day-to-day operations of the plans have been contracted to a third-party; however, the State Treasurer oversees investment options. The 457 plan and the 401k plan are combined for reporting purposes under the heading of "State Employees' Deferred Compensation Funds."

The State makes no contribution to the 457 plan, but makes matching contributions to the 401k plan as part of certain employees' compensation packages. To expand investment options, three

investment tiers were developed and made available to participants on July 1, 1997. Participants invest their contributions and accumulated earnings by selecting mutual funds in one or more of the investment tiers. Employees may, at any time, transfer accumulated balances and future contributions among mutual funds in the investment tiers. Investment earnings, net of administrative charges, are credited to the participants proportionally, based upon their balances in the plan.

The 401k plan includes loan provisions. Loans to participants are recorded as assets. The 457 plan does not include loan provisions.

Net assets available for plan benefits for the 457 plan and the 401k plan at September 30, 2002, were \$1.7 and \$1.0 billion, respectively.

NOTE 17 – INTERFUND RECEIVABLES AND PAYABLES

A. Primary Government

The balances of current interfund receivables and payables as of September 30 were (in millions):

Due From	Due To						Total
	General Fund	School Aid Fund	Non-major Governmental Funds	Unemployment Compensation Funds	Internal Service Funds	Fiduciary Funds	
General Fund	\$ -	\$ -	\$ -	\$ 1.5	\$ 1.5	\$ 14.2	\$ 17.2
School Aid Fund	614.6	-	-	-	-	-	614.6
Non-major Governmental Funds	121.8	-	244.9	-	.2	1.4	368.3
State Lottery Fund	-	23.5	-	-	-	-	23.6
Unemployment Compensation Funds	46.0	-	11.8	6.6	-	-	64.4
Non-major Enterprise Funds	-	-	-	-	-	-	.1
Internal Service Funds	-	-	-	-	47.9	.2	48.1
Fiduciary Funds	.3	-	-	-	-	.1	.3
Total	\$ 782.6	\$ 23.5	\$ 256.7	\$ 8.2	\$ 49.7	\$ 15.9	\$1,136.6

Interfund receivables and payables are recorded for 1) borrowings to eliminate negative balances in the Common Cash pool, as described in Note 5, 2) payroll liabilities for group insurance and retirement, and 3) tax accrual distributions for taxes collected in the following fiscal year.

Not included in the table above are the following interfund advances, which are not expected to be repaid within one year: \$6.2 million due from the Correctional Industries Revolving Fund (an internal service fund) to the General Fund for amounts loaned for capital construction and \$27.7 million due from the Blue Water Bridge Fund to the State Trunkline Fund (both reported as part of the State Trunkline Fund, a special revenue fund) for federal funds loaned for bridge construction.

B. Discretely Presented Component Units

Receivables and related liabilities between the primary government and the discretely presented component units, do not agree because the Michigan State Housing Development Authority and the ten State universities have a June 30 fiscal year-end.

NOTE 18 – INTERFUND COMMITMENTS

A. Mackinac Bridge Authority

The Mackinac Bridge Authority, a discretely presented component unit, has over the years received \$75.3 million of subsidies, including \$12.3 million for operations and \$63.0 million for debt service. These subsidies were provided by the State Trunkline and Michigan Transportation funds, respectively, both of which are special revenue funds.

State statutes require that the Authority continue charging bridge tolls and begin repaying the State funds for the subsidies provided. These repayments are to continue until such time as the subsidies have been completely returned. The Authority has not recorded a liability and the State funds have not recorded receivables for these subsidies because: the reimbursements

are contingent upon future net revenues, there is no repayment schedule, and the repayment commitment is long-term and budgetary in nature. Repayments may be authorized by the Authority, after consideration of the Authority's annual needs for its operations and planned repairs and improvements.

As of September 30, 2002, the Authority has repaid a total of \$9.8 million of the advance from the Michigan Transportation Fund, leaving a balance of \$53.3 million. No repayments have been made on the advance from the State Trunkline Fund.

NOTE 19 – TRANSFERS

Interfund transfers for the year ended September 30, 2002, consisted of the following (in millions):

Transferred From	Transferred To					Total
	General Fund	School Aid Fund	Non-major Governmental Funds	Unemployment Compensation Funds	Fiduciary Funds	
General Fund	\$ -	\$ 198.1	\$ 383.2	\$ -	\$.3	\$ 581.6
Budget Stabilization Fund	452.8	382.0	35.0	-	-	869.8
School Aid Fund	2.8	-	-	-	-	2.8
Non-major Governmental Funds	389.5	-	1,355.1	-	-	1,744.6
State Lottery Fund	13.1	613.5	-	-	-	626.6
Unemployment Compensation Funds	128.7	-	12.4	3.7	-	144.8
Non-major Enterprise Funds	126.8	-	-	-	-	126.8
Internal Service Funds	.7	-	-	-	-	.7
Fiduciary Funds	38.7	-	.5	-	-	39.2
Total	<u>\$ 1,153.1</u>	<u>\$ 1,193.6</u>	<u>\$ 1,786.3</u>	<u>\$ 3.7</u>	<u>\$.3</u>	<u>\$ 4,137.0</u>

Transfers are used to 1) move revenues from the fund that statute requires to collect them to the fund that statute requires to expend them, 2) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, 3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, 4) move profits from the Liquor Purchase Revolving Fund and the State Lottery Fund as required by law, 5) transfer budgetary surpluses from the General Fund to the Counter-Cyclical Budget and Economic Stabilization Fund or transfer accumulated surpluses

from the Counter-Cyclical Budget and Economic Stabilization Fund to other funds when necessary, and 6) transfer accumulated surpluses from other funds to the General Fund when authorized by statute.

In the fiscal year ended September 30, 2002, the State recorded transfers for \$452.8 million from the Counter-Cyclical Budget and Economic Stabilization Fund to the General Fund to subsidize lower than expected revenues. These transfers were made in accordance with statutory authority granted by the Legislature.

NOTE 20 – FUND DEFICITS

A. Primary Government

Governmental Funds

The Combined Environmental Protection Bond Fund, a special revenue fund, had a fund balance deficit of \$68.4 million. The deficit was caused by expenditures for projects for which bonds have not been issued.

The Combined Recreation Bond Fund – Local Projects, a special revenue fund, had a fund balance deficit of \$.4 million. The deficit was caused by expenditures for projects for which bonds have not been issued.

The Advance Financing Funds, a capital projects fund, had a fund balance deficit of \$60.2 million. The deficit was caused by expenditures for projects for which bonds have not yet been issued and for expenditures incurred to improve State-owned sites that have not been sold.

The State Building Authority, a capital projects fund, had a fund balance deficit of \$73.8 million. The deficit was caused by

amounts due to the Advance Financing Funds for reimbursable expenditures for which bond or commercial paper proceeds have not yet been received.

Proprietary Funds

The Office Services Revolving Fund, an internal service fund, had a net asset deficit of \$.6 million. The deficit resulted because rates charged were insufficient to cover expenses incurred. The rates were increased in fiscal year 2003, to eliminate the deficit.

B. Discretely Presented Component Units

All discretely presented component units have positive net asset balances as of September 30, 2002, with the exception of the Michigan Broadband Development Authority (MBDA). The MBDA fund deficit was \$1.4 million at September 30, 2002. The deficit was caused by expenses for projects for which no corresponding revenue was received.

NOTE 21 – FUND BALANCES

A. Reservations - Primary Government

The line entitled "Reserved fund balance" on the Governmental Funds Balance Sheet at September 30 consists of the following (in millions):

	General Fund	School Aid Fund	Other Special Revenue Funds	Capital Projects Funds	Permanent Funds	Total
Budgetary carry-forwards:						
Encumbrances	\$ 111.9	\$.1	\$ 91.4	\$ -	\$ 18.3	\$ 221.7
Restricted revenues	927.2	1.1	382.1	-	-	1,310.4
Multi-year projects (capital outlay and work projects)	124.0	3.1	269.0	-	17.1	413.3
Construction and debt service	-	-	45.3	33.2	-	78.5
Revolving loan programs	5.0	-	37.1	-	-	42.1
Funds held as permanent investments	-	-	112.9	-	399.7	512.6
Noncurrent assets	494.4	.7	30.9	-	-	525.9
Total Reserved Fund Balances	<u>\$ 1,662.6</u>	<u>\$ 4.9</u>	<u>\$ 968.6</u>	<u>\$ 33.2</u>	<u>\$ 435.1</u>	<u>\$ 3,104.3</u>

Budgetary carry-forwards represent unused spending authorization that continues to be available in the new year. Restricted revenue carry-forwards include revenues restricted by law for specified purposes. The largest restricted revenue carry-forwards in the General Fund are related to Medicaid Benefits Trust, \$301.7 million, and local government revenue sharing, \$197.0 million. The \$124.0 million of multi-year projects in the General Fund includes \$48.7 million of capital outlay and \$75.3 million of work project authorizations. Such amounts are reserved because the funds are legally segregated for a specific purpose.

Construction and debt service reserves represent amounts which are restricted for State Trunkline Fund's debt service and State Building Authority projects that are in process.

Reserves for revolving loan programs represent fund balance which has been appropriated for the purpose of making loans that will encourage economic development in the State. Repayments on such loans are authorized to be used to make new loans.

Funds held as permanent investments represent amounts that have been legally restricted for the purpose of providing a long-term source of investment income. These investments can include either specific investments held for the fund or portions of the fund's share of the Common Cash pool.

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Reserves are recorded for noncurrent assets if they do not represent current financial resources available for appropriation. No reservation is recorded for noncurrent assets if doing so would result in a duplicate reduction of unreserved fund balance. This occurs if the noncurrent assets have already been reserved for some other reason or if they are related to revenues that have been deferred because of not being "available."

Also, no reservations of fund balances are recorded in single purpose special revenue and debt service funds. From the overall State perspective, the unreserved fund balances of funds

other than the General Fund are restricted by the nature of the fund type and they are not available for general State purposes.

B. Net Asset Designations - Primary Government

The line "Unrestricted net assets" on the government-wide Statement of Net Assets contains designations as follows:

The State Sponsored Group Insurance Fund, an internal service fund described in Note 24, designated \$63.2 million for future catastrophic losses.

NOTE 22 – DISAGGREGATION OF PAYABLES

The line "Current Liabilities: Accounts payable and other liabilities," as presented on the government-wide Statement of Net Assets and the applicable Balance Sheets and Statements of Net Assets in the fund financial statements, consists of the following (in millions):

	General Fund	School Aid Fund	Non-major Govern- mental Funds	Other Funds	State Lottery Fund	Michigan Unemployment Compensation Funds	Liquor Purchase Revolving Fund	Total
Medicaid Programs	\$ 453.7	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 453.7
Non-Medicaid Health Programs	217.8	-	1.2	-	-	-	-	219.0
Family Independence Programs	256.8	-	.1	-	-	-	-	256.9
Transportation Programs	-	-	497.0	-	-	-	-	497.0
School Aid Programs	-	86.6	-	-	-	-	-	86.6
Merit Award Scholarships	-	-	125.8	-	-	-	-	125.8
Payroll and Withholdings	129.8	.1	13.2	-	.4	-	.4	143.9
Tax Refunds other than Income Tax	102.4	4.2	12.6	-	-	-	-	119.2
Unearned Receipts	45.8	-	5.6	-	-	-	-	51.4
Amounts Held for Others	22.1	-	2.3	-	.8	-	-	25.1
Capital Project Related	-	-	179.6	-	-	-	-	179.6
Prize Awards	-	-	-	-	129.1	-	-	129.1
Liquor Purchase	-	-	-	-	-	-	47.7	47.7
Unemployment Payments	-	-	-	-	-	35.2	-	35.2
Internal Service Fund Liabilities	-	-	-	23.2	-	-	-	23.2
Due to Fiduciary Funds*	-	-	-	15.9	-	-	-	15.9
Miscellaneous	323.1	-	89.8	-	8.9	-	-	421.7
Total	\$ 1,551.4	\$ 90.9	\$ 927.1	\$ 39.1	\$ 139.1	\$ 35.2	\$ 48.1	\$ 2,831.0

*This amount represents amounts due to fiduciary funds that were reclassified as external payables on the government-wide Statement of Net Assets.

NOTE 23 – CONTINGENCIES AND COMMITMENTS

A. Primary Government

Litigation

In the government-wide and proprietary fund financial statements, the State accrues liabilities related to significant legal proceedings if a loss is probable and reasonably estimable. In the governmental fund financial statements, liabilities are accrued when cases are settled and the amount is due and payable.

The State is a party to various legal proceedings seeking damages, injunctive, or other relief. In addition to routine litigation, certain of these proceedings could, if unfavorably resolved from the point of view of the State, substantially affect State programs or finances. These lawsuits involve programs generally in the areas of corrections; tax collection; commerce and budgetary reductions to school districts and governmental units; and court funding. Relief sought generally includes damages in tort cases; improvement of prison medical and mental health care and refund claims for State taxes. The State is also a party to various legal proceedings that, if resolved in the State's favor, would result in contingency gains to the State, but without material effect upon fund balance/net assets. The ultimate dispositions and consequences of all of these proceedings are not presently determinable, but such ultimate dispositions and consequences of any single proceeding or all legal proceedings collectively should not themselves, except as listed below, in the opinion of the Attorney General of the State and the Office of the State Budget, have a material adverse effect on the State's financial position. Those lawsuits pending which may have a significant impact or substantial effect on State programs or finances, if resolved in a manner unfavorable to the State, include the following:

10th Judicial Circuit et al v State of Michigan et al: On August 22, 1994, the Ingham Circuit and Probate Courts, together with the 55th District Court, filed suits in the Court of Claims and Ingham County Circuit Court against the State of Michigan and Ingham County entitled, 30th Judicial Circuit et al v Governor et al for declaratory and injunctive relief, and for damages, due to the alleged failure of the State Court Administrative Office to properly calculate Ingham County's reimbursement under MCL 600.9947; MSA 27A.9947, the court funding statute. The 30th Judicial Circuit et al v Governor et al case has been dismissed by stipulation of the parties because the plaintiffs are raising the same claims as members of a class action captioned as 10th Judicial Circuit et al v State of Michigan et al (Saginaw County Circuit Court No. 94-2936-AA-1/Court of Claims No. 94-15534-CM). Plaintiffs assert that the amount in controversy exceeds \$5 million. The case is currently pending final class certification.

Durant et al v State of Michigan: On November 15, 2000, more than 365 Michigan school districts and individuals filed two suits in the Michigan Court of Appeals. The first suit, Durant et al v State et al, ("Durant III") asserts that the current State School Aid appropriation act, P.A. 297 of 2000, violates Michigan Constitution, Article 9, §§ 25-34 (the "Headlee Amendment"), because it allegedly transfers per pupil revenue guaranteed to school districts under the Constitution of 1963, Article 9, § 11, for unrestricted school operating purposes, in order to satisfy the State's independent funding obligation to those school districts under Article 9, § 29. The plaintiffs in Durant III are seeking a monetary remedy, including approximately \$1.7 billion for the 1999-2000 through 2002-2003 school years for the State's alleged underfunding of special education programs and services, inclusive of special education transportation services. The Durant III plaintiffs are also requesting a declaratory judgment that the State, through P.A. 297 of 2000, is violating Article 9, § 11, and Article 9, § 29. The Durant III

plaintiffs further seek orders declaring that the State has failed, through P.A. 297 of 2000, to meet its constitutional duty to fund services and activities provided by the plaintiff school districts during school years 1999-2000 through 2002-2003 in the same proportion by which they were funded when the Headlee Amendment became effective, and that the State has reduced the State-financed proportion of necessary costs incurred by the plaintiff school districts for special education services for the 1999-2000 through 2002-2003 school years below that provided by the State when the Headlee Amendment became effective. The Durant III plaintiffs also seek an injunction permanently enjoining the State from making any future reductions below the levels of funding provided when the Headlee Amendment became effective to pay for the cost of the activities and services required of them by State law. They also seek attorneys' fees and costs of litigation.

On May 10, 2002, the Court of Appeals held that Act 297 does not violate the Michigan Constitution. On May 31, 2002, plaintiffs filed a motion for rehearing in the Court of Appeals, which was denied on July 17, 2002. Plaintiffs filed a delayed application for leave to appeal in the Michigan Supreme Court on August 14, 2002.

On November 19, 2002, the Michigan Supreme Court granted the motions for immediate consideration and for leave to file brief *amicus curiae* and denied the delayed application for leave to appeal. The plaintiffs filed a motion for reconsideration.

The second suit, Adair et al v State et al ("Adair"), asserts that the State has, by operation of law, increased the level of various specified activities and services beyond that which was required by State law as of December 23, 1978 and, subsequent to December 23, 1978, added various specified new activities or services by State law, including mandatory increases in student instruction time, without providing funding for these new activities and services, all in violation of the Headlee Amendment. In the original complaint, the Adair plaintiffs sought an unspecified money judgment equal to the reduction in the State financed proportion of necessary costs incurred by the plaintiff school districts for each school year from 1997-1998 through the date of any judgment and for attorneys' fees and litigation costs. The Adair plaintiffs also sought a declaratory judgment that the State has failed to meet its funding responsibility under the Headlee Amendment to provide the plaintiff school districts with revenues sufficient to pay for the necessary increased costs for activities and services first required by State law after December 23, 1978, and to pay for increases in the level of required activities and services beyond that which was required by State law as of December 23, 1978.

On January 2, 2001, plaintiffs filed a first amended complaint in both Durant III and Adair increasing the number of school district plaintiffs to 443. On February 22, 2001, plaintiffs filed a second amended complaint in Durant III increasing the number of school district plaintiffs to 457. On April 16, 2001, plaintiffs filed a second amended complaint in Adair increasing the number of school district plaintiffs to 463. The second amended complaint includes a request for declaratory relief, attorneys' fees and litigation costs but does not include a request for money judgment.

On April 23, 2002, the Court of Appeals dismissed the complaint in Adair in its entirety and with prejudice. Plaintiffs filed an application for leave to appeal in the Michigan Supreme Court on May 14, 2002. If the Court ultimately reverses the decision of the Court of Appeals and rules that the State has

increased the level of some or all of the challenged activities or services or mandated new activities or services without providing funding, there could be financial liability for the State.

On December 18, 2002, the Michigan Supreme Court granted plaintiffs' application for leave to appeal in *Adair*, limited to the following issues: (1) whether res judicata bars the claims of plaintiffs who were plaintiffs in *Durant I*; (2) whether the claims of those plaintiffs who were not plaintiffs in *Durant I* are barred because those districts released or waived their claims by adopting the statutory resolutions; and (3) whether the Court of Appeals erred by granting summary disposition on the record keeping claim. The ultimate disposition of the case and financial liability for the State are not presently determinable.

Jefferson Smurfit Corporation v State of Michigan: On November 24, 1999, the Michigan Court of Claims in *Jefferson Smurfit Corporation v State of Michigan*, File No. 98-17140-CM, ruled that the site-based capital acquisition deduction in Michigan's single business tax act is unconstitutional. On November 13, 2001, the Michigan Court of Appeals reversed the decision of the lower court and held that the capital acquisition deduction did not violate constitutional provisions. On December 11, 2002, the Michigan Supreme Court denied the taxpayer's application for leave to appeal. The taxpayer has until January 2, 2003 to file a motion for reconsideration. The taxpayer may also petition the United States Supreme Court for a writ of certiorari by March 11, 2003. According to the Michigan Department of Treasury, the potential financial impact of this decision is approximately \$248.3 million.

County Road Association of Michigan et al v John M. Engler et al: On March 6, 2002, the County Road Association of Michigan and the Chippewa County Road Commission filed a complaint in Ingham County Circuit Court challenging various provisions of Executive Order 2001-9. The Executive Order was proposed by the Governor and approved by the appropriations committees of both houses of the Legislature on November 6, 2001, for the purpose of reducing appropriated expenditures, to balance the State budget. The complaint consists of five counts, alleging that Defendant State agencies: (1) violated Article 9, Section 9 of the State Constitution, by unlawfully allowing the Department of State to bill the Department of Transportation for expenses in excess of those necessary to collect motor vehicle taxes and fees; (2) violated Article 9, Section 9 of the State Constitution, by utilizing, for non-transportation purposes, revenues from the sale of information or products, the creation of which was funded by constitutionally restricted transportation funds; (3) violated Article 5, Section 20 and Article 9, Section 17 of the State Constitution, and MCL 247.661 *et seq* by allowing the Department of Treasury to bill the Department of Transportation for expenses in excess of those necessary to collect motor vehicle taxes and fees; (4) violated Article 9, Section 17 of the State Constitution, by transferring funds from the Comprehensive Transportation Fund to the General Fund; and (5) violated Article 9, Section 17 of the State Constitution, by transferring funds from the Transportation Economic Development Fund to the General Fund. Three public transit authorities have intervened in the suit, asserting a single claim identical to that alleged by Plaintiffs with respect to the Comprehensive Transportation Fund. The Plaintiffs and Intervenor seek preliminary and permanent injunctive relief to nullify particular provisions of Executive Order 2001-9 and to restore funding to the Michigan Transportation Fund, the Comprehensive Transportation Fund and the Transportation Economic Development Fund. The aggregate amount at stake is in excess of \$60 million. Should the Circuit Court award the relief sought, the State of Michigan will have to provide an alternate source of funding to balance the budget and make up revenue shortfalls in excess of \$60 million.

Federal Grants

The State receives significant financial assistance from the federal government in the form of grants and entitlements. The receipt of federal grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations. Substantially all federal grants are subject to either federal single audits or financial and compliance audits by grantor agencies. Questioned costs as a result of these audits may become disallowances after the appropriate review of federal agencies. Material disallowances are recognized as fund liabilities in the government-wide and proprietary fund financial statements when the loss becomes probable and reasonably estimable. As of September 30, 2002 the State estimates that additional disallowances of recognized revenue will not be material to the general purpose financial statements.

Federal sanctions that may result in a loss to the State include \$56.9 million for the Food Stamp Program and \$151.3 million for the Child Support Enforcement System. All but \$3.9 million of the sanction relating to child support will be waived if the system is certified by the federal government in fiscal year 2002-2003.

Gain Contingencies

Certain contingent receivables related to the Family Independence Agency are not recorded as assets in these statements. Amounts recoverable from Family Independence Agency grant recipients for grant overpayments or from responsible third parties are recorded as receivables only if the amount is reasonably measurable, expected to be received within 12 months, and not contingent upon future grants or the completion of major collection efforts by the State. If recoveries are accrued and the program involves federal participation, a liability for the federal share of the recovery is also accrued. The unrecorded amount of potential recoveries, which are ultimately collectible, cannot be reasonably determined.

In November 1998, the Attorney General joined 45 other states and five territories in a settlement agreement against the nation's largest tobacco manufacturers, to seek restitution for monies spent by the states under Medicaid and other health care programs for treatment of smoking-related diseases and conditions. Michigan's share of the settlement is expected to be \$8.5 billion over the next 25 years, and then \$350 million per year, adjusted for inflation and other factors, in perpetuity. While Michigan's percentage share of the base payments will not change over time, the amount of the annual payment is subject to a number of modifications including adjustments for inflation and usage volumes. Some of the adjustments may result in increases in the payments (inflation, for example), while other adjustments will likely cause decreases in the payments (non-participating manufacturer adjustments, for example). The net effect of these adjustments on future payments is unclear, therefore only receivables and deferred revenues which can be reasonably estimated have been recorded for the future payments.

Construction Projects

The Department of Transportation has entered into construction contracts that will be paid with transportation related funds. As of September 30, 2002, the balances remaining in these contracts equaled \$624.5 million.

Contingent Liability for Local School District Bonds

Public Act 108 of 1961, as amended, resulted in a contingent liability for the bonds of any school district which are "qualified" by the Superintendent of Public Instruction. Every qualified school district is required to borrow and the State is required to lend to it any amount necessary for the school district to avoid a default on its qualified bonds. In the event that funds are not available in the School Bond Loan Fund in adequate amounts

to make such a loan, the State is required to make such loans from the General Fund. As of September 30, 2002, the principal amount of qualified bonds outstanding was 11.4 billion. Total debt service requirements on these bonds including interest will approximate \$1.0 billion in 2003. The amount of loans by the State (related to local school district bonds qualified under this program), outstanding to local school districts as of September 30, 2002, is \$578.7 million. Interest due on these loans as of September 30, 2002, is \$96.7 million.

B. Discretely Presented Component Units

Student Loan Guarantees

The Michigan Higher Education Assistance Authority (MHEAA) is contingently liable for loans made to students by financial institutions that qualify for guaranty. The State, other than MHEAA, is not liable for these loans. MHEAA's default ratio is currently below 5% for the fiscal year ended September 30, 2002. As a result, the federal government's reinsurance rate for defaults for the fiscal year ended September 30, 2002, is 100% for loans made prior to October 1, 1993, and 98% for loans made on or after October 1, 1993 to September 30, 1998. In the event of future adverse default experience, MHEAA could be liable for up to 25% of defaulted loans. Management does not expect that all guaranteed loans could default in one year. At the beginning of each fiscal year, MHEAA's reinsurance rate returns to 98%.

For loans made on or after October 1, 1998, the reinsurance rate will be 95%. In the event of future adverse default experience, MHEAA could be liable for up to 25% of such defaulted loans. Accordingly, MHEAA's expected maximum contingent liability is less than 25% of outstanding guaranteed loans; however, the maximum contingent liability at September 30, 2002, is \$659.2 million.

MHEAA entered into commitment agreements with all lenders that provide, among other things, that MHEAA will maintain cash and marketable securities. MHEAA was in compliance with this requirement as of September 30, 2002, at an amount sufficient to guarantee loans in accordance with the Higher Education Act of 1965, as amended.

Multi-Family Mortgage Loans

As of June 30, 2002, the Michigan State Housing Development Authority (MSHDA) has commitments to issue multi-family mortgage loans in the amount of \$58.5 million and single-family mortgage loans in the amount of \$18.7 million.

MSHDA has committed up to approximately \$1.1 million per year for up to 30 years from the date of completion of the respective developments (subject to three years advance notice of termination) from its accumulated reserves and future income to subsidize operations or rents for certain tenants occupying units in certain developments funded under MSHDA's multi-family program.

NOTE 24 – RISK MANAGEMENT

A. Primary Government

General

The State has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. Areas of risk where some level of insurance coverage is purchased include: aircraft liability, property and loss rental insurance that may be required by bond or lease agreements, portions of the State employee insurance benefits program, certain State artifacts, builder's risk coverage, boiler and machinery coverage, and employee bonding. Settled claims have not exceeded commercial coverage in any of the past ten fiscal years.

The State has established two internal service funds, which are described below, to account for certain aspects of the risk management program. Fund expenditures (expenses) are recognized in the paying funds in a manner similar to purchased commercial insurance. For other uninsured losses not covered by an internal service fund program, the State recognizes fund liabilities in the fund incurring the loss as follows: governmental funds record an expenditure when a loss is due and payable; proprietary funds record an expense when it is probable that a loss has occurred and the amount can be reasonably estimated. As explained more fully in Note 14, losses for workers' compensation and certain types of litigation losses have been recognized as liabilities in the government-wide financial statements.

For unemployment claims, the Unemployment Agency (UA) bills the State for the actual amount of claims paid to former State employees. The State accrues liabilities in the governmental fund financial statements for unemployment compensation, only to the extent paid by UA through September 30. During the 2001-2002 fiscal year, expenditures for payments to former State employees (not including university employees) totaled \$8.9 million. The potential liability for future payments cannot be estimated.

The State's two internal service funds, which account for certain areas of risk management, follow accounting standards established by the GASB. This results in a reporting which is very similar to that used in the private insurance industry. The various component programs within the two funds may incur deficits during a given year, but each program's surplus and unrestricted net asset balance is considered in calculating future charges or benefit levels.

Risk Management Fund

This fund was established during fiscal year 1989-1990 to account for insurance management activities implemented within the Department of Management and Budget. The automotive liability and administrative functions are accounted for as operating activities of this fund. Expenses and liabilities for claims, including incurred but not reported or not processed claims, have been recorded in the amount of \$6.6 million. This includes a long-term portion, which is recorded at \$4.3 million.

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Changes in the Risk Management Fund's claims for automobile liability for the fiscal years ending September 30, 2002 and 2001 are as follows (in millions):

	2002	2001
Balance - beginning	\$ 6.5	\$ 8.0
Current year claims and changes in estimates	1.9	1.2
Claim payments	(1.8)	(2.6)
Balance - ending	<u>\$ 6.6</u>	<u>\$ 6.5</u>

State Sponsored Group Insurance Fund

The Department of Management and Budget uses this fund to account for employee and retiree insurance benefit programs, which are largely self-funded. Expenses and liabilities for claims, which include incurred but not reported or not processed benefit claims, based on preliminary estimates from the plan administrators, have been recorded as liabilities in the amount of \$172.7 million. This includes a long-term portion, which is recorded at a discounted present value of \$72.8 million using a discount rate of 10.5% (first 10 years of disability), 9.0% (next 10 years), and 6.0% thereafter for claims incurred prior to January 1, 1992. Claims incurred in past years were discounted using rates as follows in the calculation of incurred but not reported claims: 1993 and 1994 used a rate of 6.0%, 1995 used a rate of 6.25%, 1996 and 1997 used a rate of 5.75%, and 1998 through 2002 used a rate of 5.25%.

Payments to the State Sponsored Group Insurance Fund are based on estimates of amounts needed to pay prior and current year claims. In addition, a portion of the fund's net assets has been designated for catastrophic losses. The risk management designation represents the level of reserves that should be maintained to ease large fluctuations in premium levels in years of unexpected excessive claims. That designation was \$63.2 million at September 30, 2002. Unrestricted net assets totaled \$85.4 million at September 30, 2002.

Changes in the State Sponsored Group Insurance Fund's claims liability for employee and retiree insurance benefit programs for the fiscal years ending September 30, 2002 and 2001 are as follows (in millions):

	2002	2001
Balance - beginning	\$ 183.7	\$ 184.0
Current year claims and changes in estimates	556.0	516.9
Claim payments	(567.0)	(517.2)
Balance - ending	<u>\$ 172.7</u>	<u>\$ 183.7</u>

B. Discretely Presented Component Units

State Universities

The State university component units participate with the other Michigan public universities in the Michigan Universities Self-Insurance Corporation (MUSIC), which provides indemnity to its members against comprehensive general liability, errors and omissions losses, and property damage commonly covered by insurance. Loss coverages for comprehensive general liability and property are structured on a three-layer basis with each member retaining a portion of its losses, MUSIC covering the second layer, and commercial carriers covering the third layer. For all policy years through June 30, 1993, errors and omissions coverage was structured on a two-layer basis with no excess insurance provided. Effective July 1, 1993, MUSIC obtained excess insurance coverage from commercial carriers covering the third layer. For automobile liability there is no member retention. Comprehensive general liability, property and automobile liability coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims made basis.

NOTE 25 – SUBSEQUENT EVENTS

A. Long-Term Borrowing

In October 2002, the State of Michigan issued its Multi-Modal General Obligation School Loan Bonds, Series 2002B in the aggregated principal amount of \$47.3 million. The Series 2002B Bonds were issued in the Commercial Paper Rate Mode. The Bonds will mature on March 1, 2021.

Subsequent to year-end, the State Building Authority issued \$54.2 million in commercial paper.

B. Long-Term Borrowing - Discretely Presented Component Units

Subsequent to their respective year-ends, the following discretely presented component units issued bonds (in millions):

	Amount
Michigan Broadband Development Authority	\$ 16.7
Michigan State Hospital Finance Authority	177.8
Michigan State Housing Development Authority	253.0
Michigan Municipal Bond Authority	17.0
Ferris State University	10.3
Grand Valley State University	18.0
Northern Michigan University	6.0
Western Michigan University	19.3
Total	<u>\$ 518.1</u>

Disclosures regarding these bonds and transactions are available in the separately issued reports of the various organizations.



II FINANCIAL SECTION

REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION

BUDGETARY COMPARISON SCHEDULE
MAJOR GOVERNMENTAL FUNDS
 SEPTEMBER 30, 2002
 (In Thousands)

	GENERAL FUND			VARIANCE WITH FINAL BUDGET
	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	
Beginning budgetary fund balance	\$ 1,485,399	\$ 1,485,399	\$ 1,485,399	\$ -
Resources (inflows):				
General Purpose Revenues:				
Taxes	8,975,900	8,142,358	8,142,358	-
Federal	45,000	24,727	24,727	-
Local	1,300	751	751	-
Licenses and permits	25,000	16,452	16,452	-
Services	6,000	5,233	5,233	-
Miscellaneous	63,000	134,731	134,731	-
Transfers in	154,000	957,122	957,122	-
Restricted Revenues:				
Taxes	1,790,982	2,351,222	2,351,222	-
Federal	8,555,490	8,926,998	8,926,998	-
Local	1,186,001	1,224,075	1,224,075	-
Licenses and permits	255,568	216,908	216,908	-
Services	173,907	115,773	115,773	-
Miscellaneous	795,960	370,221	370,221	-
Transfers in	91,068	195,974	195,974	-
Total Revenue Inflows	<u>22,119,176</u>	<u>22,682,546</u>	<u>22,682,546</u>	-
Amounts Available for Appropriation	<u>23,604,574</u>	<u>24,167,944</u>	<u>24,167,944</u>	-
Charges to Appropriations (outflows):				
Legislative Branch	149,230	131,260	131,005	255
Judicial Branch	250,311	237,781	237,506	275
Executive Branch:				
Agriculture	120,460	101,858	100,585	1,273
Attorney General	64,461	56,643	55,752	890
Career Development	527,744	456,962	456,661	300
Civil Rights	16,510	15,758	14,737	1,021
Civil Service	32,344	32,055	31,419	636
Colleges and Universities Grants	2,135,764	2,134,685	2,134,428	257
Community Health	8,576,050	9,275,330	9,254,043	21,287
Consumer and Industry Services	302,860	235,504	231,516	3,988
Corrections	1,774,646	1,685,712	1,675,632	10,080
Education	1,203,918	1,112,738	1,111,538	1,200
Environmental Quality	369,710	221,489	219,254	2,235
Executive Office	5,720	5,491	5,472	19
Family Independence Agency	3,876,282	3,886,795	3,873,793	13,002
History, Arts & Libraries	81,184	76,911	74,368	2,544
Management and Budget	725,506	654,844	636,031	18,813
Military and Veterans Affairs	98,180	100,344	99,083	1,261
Natural Resources	118,936	98,084	97,603	482
State	190,758	176,600	174,049	2,551
State Police	426,933	411,800	410,512	1,289
Transportation	41,503	14,999	14,999	-
Treasury	1,980,308	2,510,031	2,503,970	6,060
Intrafund expenditure reimbursements	-	(618,017)	(618,017)	-
Total Charges to Appropriations	<u>23,069,317</u>	<u>23,015,657</u>	<u>22,925,940</u>	<u>89,717</u>
Reconciling Items:				
Encumbrances at September 30	-	111,948	111,948	-
Change in noncurrent assets	-	(71,226)	(71,226)	-
Net Reconciling Items	-	40,723	40,723	-
Ending Budgetary Fund Balance	<u>\$ 535,257</u>	<u>\$ 1,193,010</u>	<u>\$ 1,282,728</u>	<u>\$ 89,717</u>

Michigan

COUNTER-CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND				SCHOOL AID FUND			
ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET	ORIGINAL BUDGET	FINAL BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET
\$ 994,187	\$ 994,187	\$ 994,187	\$ -	\$ 702,861	\$ 702,861	\$ 702,861	\$ -
-	-	-	-	9,595,187	9,520,335	9,520,335	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
71,600	20,794	20,794	-	-	14,709	14,709	-
-	-	-	-	594,000	963,530	963,530	-
-	-	-	-	-	-	-	-
-	-	-	-	203,000	183,019	183,019	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	237,614	230,091	230,091	-
71,600	20,794	20,794	-	10,629,800	10,911,684	10,911,684	-
1,065,787	1,014,981	1,014,981	-	11,332,661	11,614,545	11,614,545	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	11,458,647	11,418,511	11,373,939	44,572
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
222,000	869,831	869,831	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
222,000	869,831	869,831	-	11,458,647	11,418,511	11,373,939	44,572
-	-	-	-	-	76	76	-
-	-	-	-	-	600	600	-
-	-	-	-	-	677	677	-
\$ 843,787	\$ 145,150	\$ 145,150	\$ -	\$ (125,986)	\$ 196,710	\$ 241,282	\$ 44,572

REQUIRED SUPPLEMENTARY INFORMATION

BUDGETARY COMPARISON SCHEDULE

BUDGET-TO-GAAP RECONCILIATION

SEPTEMBER 30, 2002

(In Thousands)

	GENERAL FUND	COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND	SCHOOL AID FUND
Sources/inflows of resources			
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule	\$ 24,167,944	\$ 1,014,981	\$ 11,614,545
Differences - budget to GAAP:			
Budgetary fund balance at the beginning of the year is a budgetary resource but is not a current-year revenue for financial reporting purposes.	(1,485,399)	(994,187)	(702,861)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes.	(1,153,096)	-	(1,193,621)
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds.	<u>\$ 21,529,450</u>	<u>\$ 20,794</u>	<u>\$ 9,718,063</u>
Uses/outflows of resources			
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule.	\$ 22,925,940	\$ 869,831	\$ 11,373,939
Differences - budget to GAAP:			
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes, but in the year the supplies are received for financial reporting purposes.	(111,948)	-	(76)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.	(581,611)	(869,831)	(2,829)
Capital lease acquisitions are not outflows of budgetary resources but are recorded as current expenditures and other financing sources under GAAP.	234,468	-	-
Total expenditures as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds.	<u>\$ 22,466,848</u>	<u>\$ -</u>	<u>\$ 11,371,034</u>

Required Supplementary Information

Notes to Required Supplementary Information – Budgetary Reporting

Statutory/Budgetary Presentation

The various funds and programs within funds utilize a number of different budgetary control processes. Annual legislative appropriations and revenue estimates are provided for most “operating” funds. (Note 2 of the basic financial statements identifies the annually budgeted operating funds.)

The original executive budget and original legislative appropriations provide general purpose (unrestricted) revenue estimates in order to demonstrate compliance with constitutional provisions. Revenues restricted by law or outside grantors to a specific program are estimated at a level of detail consistent with controlling related expenditure accounts.

For programs financed from restricted revenues, spending authorization is generally contingent upon recognition of the related revenue. Reductions of spending authority occur if revenues fall short of estimates. If revenues exceed the estimate, supplemental appropriations are required before the additional resources can be spent.

The budgetary comparison schedule presented for the General Fund, the Budget Stabilization Fund, and the School Aid Fund presents both the original and final appropriated budgets for fiscal year 2001-2002, as well as the actual resource inflows, outflows and fund balance stated on the budgetary basis. The supplementary portion of this report includes a Combining Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual, by fund type, for non-major special revenue and permanent funds with annual budgets. Those schedules only include the final appropriated budget.

The original budget and related estimated revenues represent the spending authority enacted into law by the appropriation bills as of October 1, 2001, and includes encumbrance and multi-year projects budgetary carry-forwards from the prior fiscal year.

The budgetary fund balance represents total fund balance, net of reserves for noncurrent assets. Reserves for noncurrent assets do not represent current financial resources available for appropriation and are removed for budgetary purposes.

Generally accepted accounting principles (GAAP) require that the final legal budget be reflected in the “final budget” column, therefore updated revenue estimates available for appropriations as of November 30, rather than the amounts shown in the original budget, are reported. The November 30 date is used because P.A. 431 of 1984, as amended, permits budget adjustments by the Legislature through 60 days after year-end.

The final appropriations budget represents original and supplemental appropriations, carry-forwards, carry-backs (i.e., current year appropriations for prior year overdrafts), approved transfers, executive order reductions, and timing differences. Expenditures, transfers out, other financing uses, and encumbrances are combined and classified by department rather than being reported by character and function as shown in the GAAP statements. This departmental classification is used to better reflect organizational responsibility and to be more consistent with the budget process. Appropriations include interagency expenditure reimbursement, in which one agency provides funding to another agency within the same fund. The final budget and actual amounts are adjusted to eliminate the duplication.

The timing differences result from unspent authorizations for multi-year projects, such as capital outlay and work projects, and from restricted revenues that had not been appropriated for expenditure in the current year. Such authorization balances remaining at year-end are removed from the final budget column to provide an “annualized” budget.

Positive “variances” reflect restricted revenues that were appropriated and available for expenditure in the current year and unused general purpose spending authority (lapses); negative “variances” reflect budgetary overdrafts. If both positive and negative variances exist for a particular line, the amount shown is the net variance.

Statutory/Budgetary Reconciliation

The statutory/budgetary basis presentation differs from GAAP in ways that do not affect ending fund balance.

For budgetary reporting purposes, expenditures and transfers out in the “Actual” column include recorded encumbrances, because they are considered uses of spending authority in the year the State incurs an obligation. The “Original” and “Final Budget” columns include encumbrance authorization balances carried over from the prior fiscal year, because they provided spending authority in the current year. In the GAAP basis statements, expenditures do not include encumbrances. The effect of this difference is reflected as a reconciling item on the Budgetary Comparison Schedule for the major funds and the Combining Schedule of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual for the non-major special revenue funds and permanent funds. The encumbrance of spending authority is recorded as a reservation of fund balance under both bases of accounting.

For budgetary purposes, capitalizable lease expenditures are recognized when payments are due, rather than upon lease inception as required by GAAP. This difference does not affect fund balance because the “other financing sources” recorded under GAAP at lease inception are not recorded on the statutory/budgetary basis.

Required Supplementary Information

Information About Infrastructure Assets Reported Using the Modified Approach

As allowed by GASB Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis - for State and Local Governments, the State has adopted an alternative process for recording depreciation expense on selected infrastructure assets. Under this alternative method, referred to as the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 27,423 lane miles of roads, 4,652 bridges (spans in excess of 20 feet), and 1,123 other spans (less than 20 feet) that the State is responsible to maintain.

In order to utilize the modified approach, the State is required to:

- Maintain an asset management system that includes an up-to-date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.
- Estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the State.
- Document that the assets are being preserved approximately at, or above, the established condition level.

Roads

Measurement Scale

The Michigan Department of Transportation (MDOT) uses numerous methods to determine the condition of roadway pavements; however, the Sufficiency Rating serves as the State’s primary method to measure and monitor pavement conditions. In use since 1961, the Sufficiency Rating is a visual analysis conducted by an engineer and includes a 5-point scale, as follows:

Rating	Bituminous Surface	Concrete Surface
1.0 = Excellent	Pavement shows no visible deterioration. Distresses are non-existent.	Same
2.0 = Good	Some indication of initial deterioration, but not yet requiring appreciable amounts of maintenance. Distress items include the start of small transverse and/or longitudinal cracks. Slight rutting may be apparent in the wheel path.	Some indication of initial deterioration, but not yet requiring appreciable amounts of maintenance. Distress items may include the start of small transverse and/or longitudinal cracks, or slight seam and joint separation. Joints may show very small amounts of deterioration.
3.0 = Fair	Average deterioration requiring occasional routine maintenance. Distresses may include minor transverse and longitudinal cracking becoming continuous throughout the segment. Severe cracking is patched effectively. Rutting may be a little more severe and hold small amounts of water.	Average deterioration requiring occasional routine maintenance. Distresses may include minor transverse and longitudinal cracking becoming continuous throughout the segment. Severe cracking is patched effectively. Through lanes and shoulders may begin to show separation from failing tie bars.
4.0 = Poor	Excessive deterioration requiring frequent maintenance and warrants resurfacing soon. Distress may be evident in wide transverse and longitudinal cracks. Severe “shallow cracking” could be evident if the pavement is composite. If the segment has been patched, the cracks may be showing through. Rutting is severe and may effect driving.	Excessive deterioration requiring frequent maintenance and warrants resurfacing soon. Distress may be evident in wide transverse and longitudinal cracks. If the segment has been patched, cracks may be showing through. Joint repairs could begin to fail. Shoulder and/or through-lane separation may be apparent. Popouts or spalling could also be present in the section.
5.0 = Very Poor /Failed	Extreme deterioration requiring continuous maintenance and warrants resurfacing or total cross-section replacement. Distress items may include severe transverse and longitudinal cracking or severe alligator cracking. Shadow cracking in composite pavement is wider than 1”. Rutting in wheel path may be severe and patching is no longer beneficial to pavement condition.	Extreme deterioration requiring continuous maintenance and warrants resurfacing or total cross-section replacement. Distress items may include severe transverse and longitudinal cracking, joints are failed, and the patching is no longer beneficial to pavement condition. Spalling and edge cracking could also be severe.

Established Condition Level

No more than 30% of the pavements shall be rated as “poor” or “very poor.”

Assessed Conditions

The State assesses condition on a calendar year basis. The following table reports the percentage of pavements meeting ratings of “Good” or “Poor”, for the past five years. “Good” represents ratings of 1.0 through 3.0 above and “Poor” represents ratings of 4.0 and 5.0.

Rating	2001	2000	1999	1998	1997
Good	78%	78%	75%	73%	69%
Poor	22%	22%	25%	27%	31%

Bridges

Measurement Scale

MDOT utilizes the National Bridge Inventory to monitor the condition of the 4,652 bridges and 1,123 other spans under its jurisdiction. The inventory rates bridges, including the deck, superstructure and substructure, using a 10-point scale:

Rating	Description
9	Excellent (no specific definition).
8	Very good.
7	Good. Some minor problems.
6	Satisfactory. Structural elements show some minor deterioration.
5	Fair. All primary structural elements are sound but may have minor section loss, cracking, spalling, or scour.
4	Poor. Advanced section loss, deterioration, spalling, or scour.
3	Serious. Loss of section, deterioration, spalling, or scour have seriously affected primary structural components. Local failures are possible. Fatigue cracks in steel or shear cracks in concrete may be present.
2	Critical. Advanced deterioration of primary structural elements. Fatigue cracks in steel or shear cracks in concrete may be present or scour may have removed substructure support. Unless closely monitored it may be necessary to close the bridge until corrective action is taken.
1	Imminent failure. Major deterioration or section loss present in critical structural components or obvious vertical or horizontal movement affecting structure stability. Bridge is closed to traffic, but corrective action may put it back in light service.
0	Failure. Out of service; beyond corrective action.

Established Condition Level

No more than 35% of the bridges shall be rated as "structurally deficient."

Assessed Conditions

"Structurally deficient" results when a condition of 4 or worse is assessed to at least one of the major structural elements (e.g. the deck, superstructure, or substructure). The following table reports the percentage of bridges whose condition was assessed as "structurally deficient", in the stated year:

Calendar Year	Structurally Deficient
2001	20.9%
2000	22.5%
1999	18.9%
1998	19.2%
1997	16.7%

Budgeted and Estimated Costs to Maintain

The following table presents the State's estimate of spending necessary to preserve and maintain the roads and bridges at, or above, the "Established Condition Levels" cited above, and the actual amount spent during the past five fiscal years (in millions):

Fiscal Year	Estimated Spending	Actual Spending
2002-2003	\$873.6	-
2001-2002	\$993.3	\$798.2
2000-2001	\$984.3	\$915.2
1999-2000	\$817.4	\$895.3
1998-1999	\$831.8	\$822.0
1997-1998	\$688.1	\$693.5

The budgeting process utilized by the Department of Transportation results in spending in one fiscal year from amounts that were budgeted in a previous year(s). Therefore, this timing difference does not allow a true comparison of amounts budgeted and spent within a given year. This table, and other tables within this narrative demonstrate that the State has incurred the necessary expenditures to meet its desired condition levels.

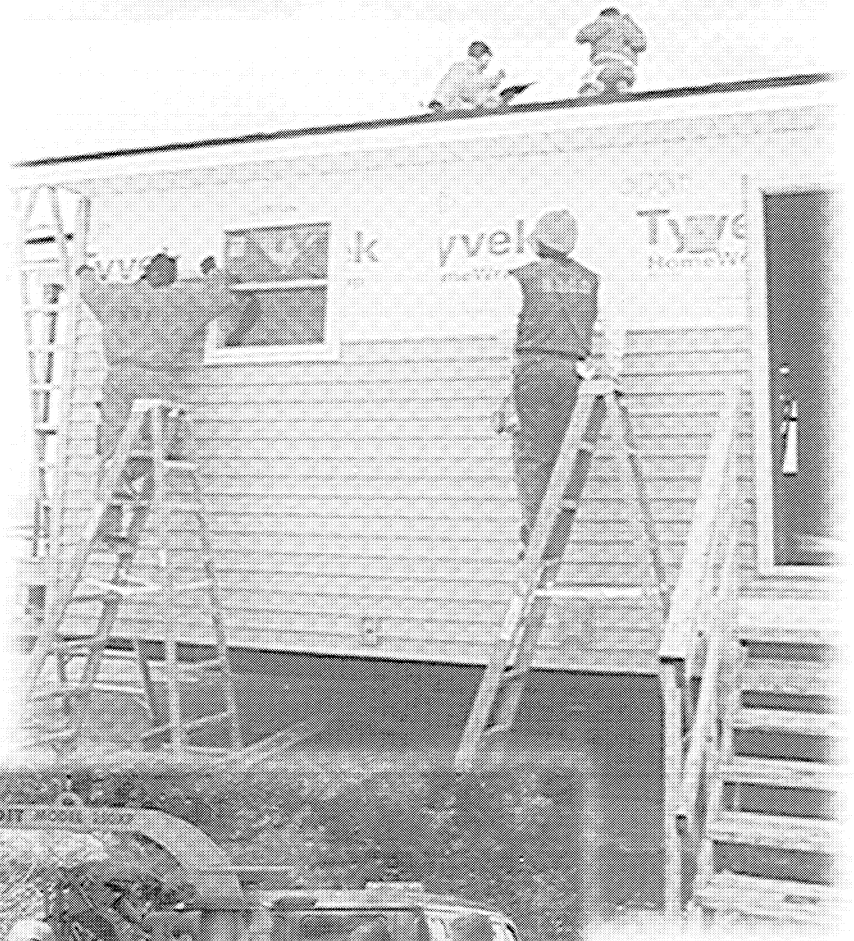


TOP:

The Michigan Prison Build Program, which puts prisoners to work building housing components for non-profit organizations such as Habitat for Humanity, is the only one of its kind in the nation. It gives low-income families an opportunity to own their own homes and helps offenders learn job skills.

BOTTOM:

Public works assignments are an important restitution tool for offenders. Those already in the community and qualified offenders in low-security prisons work under the supervision of staff cleaning parks, maintaining hiking trails, and tackling other jobs that communities could not otherwise afford, to compensate for their crimes.





TOP:

The newly remodeled Southern Michigan Correctional Facility near Jackson is equipped with state-of-the-art control centers which allow full viewing of the cellblock. All secure prisons have elaborate perimeter security systems including electronic detection devices.

BOTTOM:

Bellamy Creek Correctional Facility in Ionia is Michigan's newest correctional facility. It opened late in 2001 and houses about 1,900 male offenders. This facility uses a state-of-the-art security system including electronic detection devices, special fences, and video tracking cameras.



II FINANCIAL SECTION

COMBINING AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES - NON-MAJOR FUNDS

Michigan

BALANCE SHEET
NON-MAJOR GOVERNMENTAL FUNDS - BY FUND TYPE
 SEPTEMBER 30, 2002
 (In Thousands)

					TOTALS
	SPECIAL REVENUE	DEBT SERVICE	CAPITAL PROJECTS	PERMANENT FUNDS	SEPTEMBER 30, 2002
ASSETS					
Current Assets:					
Cash	\$ 2,288	\$ 5,125	\$ -	\$ -	\$ 7,413
Equity in common cash	1,836,785	6,534	11,151	137,038	1,991,508
Taxes, interest, and penalties receivable	128,973	-	-	-	128,973
Amounts due from other funds	108,260	5,577	142,834	-	256,671
Amounts due from component units	711	-	34,529	-	35,240
Amounts due from federal agencies	203,931	-	283	-	204,214
Amounts due from local units	59,186	-	15,090	124	74,400
Inventories	8,334	-	-	-	8,334
Investments	-	380,891	70,319	-	451,210
Securities lending collateral	4,843	-	-	31,236	36,079
Other current assets	30,003	622	562	11,206	42,393
Total Current Assets	<u>2,383,315</u>	<u>398,749</u>	<u>274,768</u>	<u>179,604</u>	<u>3,236,436</u>
Taxes, interest, and penalties receivable	4,643	-	-	-	4,643
Advances to other funds	27,734	-	-	-	27,734
Amounts due from local units	44,711	-	-	-	44,711
Investments	87,791	14,641	-	339,767	442,199
Other noncurrent assets	7,222	-	-	-	7,222
Total Assets	<u>\$ 2,555,416</u>	<u>\$ 413,389</u>	<u>\$ 274,768</u>	<u>\$ 519,371</u>	<u>\$ 3,762,944</u>
LIABILITIES AND FUND BALANCES					
Current Liabilities:					
Warrants outstanding	\$ 17,586	\$ -	\$ 430	\$ 1,307	\$ 19,324
Obligations under security lending	4,843	-	-	31,236	36,079
Accounts payable and other liabilities	727,672	5,478	182,824	11,150	927,125
Amounts due to other funds	150,442	1,008	216,807	16	368,273
Amounts due to component units	-	-	-	100	100
Interest payable	-	-	333	-	333
Deferred revenue	49,519	-	-	-	49,519
Total Current Liabilities	<u>950,062</u>	<u>6,486</u>	<u>400,395</u>	<u>43,810</u>	<u>1,400,753</u>
Long-Term Liabilities:					
Advances from other funds	27,734	-	-	-	27,734
Deferred revenue	22,496	-	-	-	22,496
Total Liabilities	<u>1,000,293</u>	<u>6,486</u>	<u>400,395</u>	<u>43,810</u>	<u>1,450,984</u>
Fund Balances:					
Reserved fund balance	968,583	-	33,150	435,102	1,436,835
Unreserved fund balance (deficit)	586,540	406,903	(158,776)	40,459	875,126
Total Fund Balances	<u>1,555,123</u>	<u>406,903</u>	<u>(125,627)</u>	<u>475,561</u>	<u>2,311,961</u>
Total Liabilities and Fund Balances	<u>\$ 2,555,416</u>	<u>\$ 413,389</u>	<u>\$ 274,768</u>	<u>\$ 519,371</u>	<u>\$ 3,762,944</u>

Michigan

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
NON-MAJOR GOVERNMENTAL FUNDS - BY FUND TYPE
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

					TOTALS
	SPECIAL REVENUE	DEBT SERVICE	CAPITAL PROJECTS	PERMANENT FUNDS	SEPTEMBER 30, 2002
REVENUES					
Taxes	\$ 2,056,493	\$ -	\$ -	\$ -	\$ 2,056,493
From federal agencies	1,067,601	-	550	822	1,068,973
From local agencies	133,273	-	-	-	133,273
From services	844	-	-	-	844
From licenses and permits	175,386	-	-	-	175,386
Miscellaneous	609,732	6,553	1,359	60,289	677,933
	<u>4,043,328</u>	<u>6,553</u>	<u>1,909</u>	<u>61,112</u>	<u>4,112,901</u>
Total Revenues					
EXPENDITURES					
Current:					
General government	146,678	1,408	1,472	-	149,558
Education	130,168	822	196,121	-	327,111
Family independence services	-	-	-	2,601	2,601
Public safety and corrections	797	-	-	4,105	4,903
Conservation, environment, recreation, and agriculture	272,162	-	337	11,401	283,900
Labor, commerce, and regulatory	207,960	-	-	-	207,960
Health services	82,167	-	-	-	82,167
Transportation	2,117,153	1,299	-	-	2,118,452
Capital outlay	1,172,017	-	194,309	39,012	1,405,338
Debt Service:					
Bond principal retirement	-	226,801	-	-	226,801
Bond interest and fiscal charges	1,240	224,438	-	-	225,678
Capital lease payments	1,072	-	-	-	1,072
	<u>4,131,414</u>	<u>454,768</u>	<u>392,239</u>	<u>57,119</u>	<u>5,035,541</u>
Total Expenditures					
Excess of Revenues over (under) Expenditures	(88,086)	(448,215)	(390,330)	3,993	(922,639)
OTHER FINANCING SOURCES (USES)					
Bonds and notes issued	415,388	-	572,462	-	987,850
Premium on bond issuance	9,084	41,811	13,344	-	64,238
Refunding bonds issued	-	488,145	-	-	488,145
Payment to refunded bond escrow agent	-	(527,303)	-	-	(527,303)
Extinguishment of commercial paper	-	-	(51,890)	-	(51,890)
Capital lease acquisitions	2,804	-	-	-	2,804
Transfers from other funds	1,076,552	537,746	161,971	10,010	1,786,280
Transfers to other funds	(1,571,802)	(4,001)	(158,719)	(10,102)	(1,744,624)
	<u>(67,974)</u>	<u>536,398</u>	<u>537,168</u>	<u>(92)</u>	<u>1,005,500</u>
Total Other Financing Sources (Uses)					
Excess of Revenues and Other Sources over (under) Expenditures Other Uses	(156,060)	88,182	146,838	3,901	82,861
Fund Balances - Beginning of fiscal year	1,711,183	318,721	(272,464)	471,660	2,229,100
Fund Balances - End of fiscal year	<u>\$ 1,555,123</u>	<u>\$ 406,903</u>	<u>\$ (125,627)</u>	<u>\$ 475,561</u>	<u>\$ 2,311,961</u>

Michigan

BALANCE SHEET
SPECIAL REVENUE FUNDS - BY CLASSIFICATION
 SEPTEMBER 30, 2002
 (In Thousands)

	TRANSPORTATION RELATED	CONSERVATION, ENVIRONMENT, AND RECREATION RELATED	REGULATORY AND ADMINISTRATIVE RELATED	OTHER STATE FUNDS	TOTALS SEPTEMBER 30, 2002
ASSETS					
Current Assets:					
Cash	\$ 2,142	\$ 133	\$ 13	\$ -	\$ 2,288
Equity in common cash	1,292,026	265,426	57,185	222,147	1,836,785
Taxes, interest, and penalties receivable	122,315	6,657	-	-	128,973
Amounts due from other funds	61,422	35,020	11,818	-	108,260
Amounts due from component units	711	-	-	-	711
Amounts due from federal agencies	192,287	1,606	10,038	-	203,931
Amounts due from local units	58,806	380	-	-	59,186
Inventories	8,287	47	-	-	8,334
Securities lending collateral	-	4,843	-	-	4,843
Other current assets	16,957	11,383	811	852	30,003
Total Current Assets	1,754,955	325,497	79,865	222,999	2,383,315
Taxes, interest, and penalties receivable	4,322	321	-	-	4,643
Advances to other funds	27,734	-	-	-	27,734
Amounts due from local units	40,069	4,642	-	-	44,711
Investments	-	87,791	-	-	87,791
Other noncurrent assets	5,611	437	-	1,174	7,222
Total Assets	\$ 1,832,691	\$ 418,688	\$ 79,865	\$ 224,172	\$ 2,555,416
LIABILITIES AND FUND BALANCES					
Current Liabilities:					
Warrants outstanding	\$ 11,932	\$ 4,284	\$ 1,022	\$ 347	\$ 17,586
Obligations under security lending	-	4,843	-	-	4,843
Accounts payable and other liabilities	519,993	66,078	12,090	129,511	727,672
Amounts due to other funds	95,075	39,691	15,669	7	150,442
Deferred revenue	42,392	2,197	4,176	754	49,519
Total Current Liabilities	669,392	117,092	32,958	130,620	950,062
Long-Term Liabilities:					
Advances from other funds	27,734	-	-	-	27,734
Deferred revenue	21,597	758	-	141	22,496
Total Liabilities	718,722	117,850	32,958	130,762	1,000,293
Fund Balances:					
Reserves For:					
Budgetary Carry-Forwards:					
Encumbrances	62,716	18,033	390	10,229	91,367
Restricted revenues	239,252	139,356	3,462	-	382,070
Multi-year projects	203,850	51,987	-	13,158	268,996
Construction and debt service	45,315	-	-	-	45,315
Revolving loan programs	31,590	5,473	-	-	37,062
Funds held as permanent investments	-	112,909	-	-	112,909
Noncurrent assets	29,690	-	-	1,174	30,864
Total Reserved	612,412	327,758	3,852	24,561	968,583
Unreserved	501,556	(26,920)	43,055	68,850	586,540
Total Fund Balances	1,113,968	300,837	46,907	93,411	1,555,123
Total Liabilities and Fund Balances	\$ 1,832,691	\$ 418,688	\$ 79,865	\$ 224,172	\$ 2,555,416

Michigan

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE FUNDS - BY CLASSIFICATION
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

	TRANSPORTATION RELATED	CONSERVATION, ENVIRONMENT, AND RECREATION RELATED	REGULATORY AND ADMINISTRATIVE RELATED	OTHER STATE FUNDS	TOTALS SEPTEMBER 30, 2002
REVENUES					
Taxes	\$ 1,995,635	\$ 60,858	\$ -	\$ -	\$ 2,056,493
From federal agencies	944,540	3,020	120,040	-	1,067,601
From local agencies	133,273	-	-	-	133,273
From services	838	-	6	-	844
From licenses and permits	74,398	92,380	8,609	-	175,386
Miscellaneous	64,617	76,099	65,117	403,898	609,732
Total Revenues	3,213,301	232,357	193,772	403,898	4,043,328
EXPENDITURES					
Current:					
General government	-	326	14,086	132,266	146,678
Education	-	-	-	130,168	130,168
Public safety and corrections	-	-	-	797	797
Conservation, environment, recreation, and agriculture	-	272,162	-	-	272,162
Labor, commerce, and regulatory	-	-	184,531	23,429	207,960
Health services	-	1,435	-	80,732	82,167
Transportation	2,117,153	-	-	-	2,117,153
Capital outlay	1,156,778	15,239	-	-	1,172,017
Debt Service:					
Bond interest and fiscal charges	-	-	-	1,240	1,240
Capital lease payments	252	-	820	-	1,072
Total Expenditures	3,274,182	289,162	199,437	368,632	4,131,414
Excess of Revenues over (under) Expenditures	(60,881)	(56,805)	(5,665)	35,266	(88,086)
OTHER FINANCING SOURCES (USES)					
Bonds and notes issued	282,310	35,353	-	97,725	415,388
Premium on bond issuance	6,722	2,361	-	-	9,084
Capital lease acquisitions	-	-	2,804	-	2,804
Transfers from other funds	1,032,024	30,394	14,134	-	1,076,552
Transfers to other funds	(1,209,568)	(81,585)	(23,773)	(256,877)	(1,571,802)
Total Other Financing Sources (Uses)	111,489	(13,477)	(6,834)	(159,152)	(67,974)
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses	50,608	(70,282)	(12,500)	(123,886)	(156,060)
Fund Balances - Beginning of fiscal year	1,063,361	371,119	59,407	217,297	1,711,183
Fund Balances - End of fiscal year	\$ 1,113,968	\$ 300,837	\$ 46,907	\$ 93,411	\$ 1,555,123

Michigan

**SCHEDULE OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL -
SPECIAL REVENUE FUNDS - BY CLASSIFICATION**
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

<u>Statutory/Budgetary Basis</u>	TRANSPORTATION RELATED			CONSERVATION, ENVIRONMENT, AND RECREATION RELATED		
	BUDGET	ACTUAL	VARIANCE	BUDGET	ACTUAL	VARIANCE
REVENUES AND OTHER SOURCES						
Taxes	\$ 1,995,635	\$ 1,995,635	\$ -	\$ 344	\$ 344	\$ -
From federal agencies	701,066	701,066	-	3,020	3,020	-
From local agencies	47,907	47,907	-	-	-	-
From services	838	838	-	-	-	-
From licenses and permits	74,398	74,398	-	92,380	92,380	-
Miscellaneous	55,886	55,886	-	28,987	28,987	-
Transfers in	1,018,496	1,018,496	-	26,394	26,394	-
Total Revenues and Other Sources	3,894,226	3,894,226	-	151,124	151,124	-
EXPENDITURES, TRANSFERS OUT, AND ENCUMBRANCES - BY BRANCH, DEPARTMENT/AGENCY						
Career Development	-	-	-	-	-	-
Colleges and Universities Grants	-	-	-	-	-	-
Community Health	-	-	-	-	-	-
Consumer and Industry Services	-	-	-	-	-	-
Management and Budget	-	-	-	-	-	-
Natural Resources	-	-	-	179,034	171,275	7,759
Transportation	4,076,819	3,882,506	194,313	-	-	-
Treasury	-	-	-	-	-	-
Total Expenditures, Transfers Out, and Encumbrances	4,076,819	3,882,506	194,313	179,034	171,275	7,759
Revenues and Other Sources over (under) Expenditures, Encumbrances, and Other Uses (Statutory/budgetary basis)	\$ (182,594)	11,719	\$ 194,313	\$ (27,909)	(20,151)	\$ 7,759
Reconciling Items:						
Encumbrances at September 30		62,716			15,055	
Funds not annually budgeted		(23,828)			(65,186)	
Net Reconciling Items		38,888			(50,131)	
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses (GAAP Basis)		50,608			(70,282)	
FUND BALANCES (GAAP BASIS)						
Beginning balances		1,063,361			371,119	
Ending balances (GAAP Basis)		\$ 1,113,968			\$ 300,837	

Michigan

REGULATORY AND ADMINISTRATIVE RELATED			OTHER STATE FUNDS			TOTALS		
BUDGET	ACTUAL	VARIANCE	BUDGET	ACTUAL	VARIANCE	BUDGET	ACTUAL	VARIANCE
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,995,978	\$ 1,995,978	\$ -
120,040	120,040	-	-	-	-	824,127	824,127	-
-	-	-	-	-	-	47,907	47,907	-
6	6	-	-	-	-	844	844	-
8,609	8,609	-	-	-	-	175,386	175,386	-
35,782	35,782	-	335,451	335,451	-	456,105	456,105	-
13,371	13,371	-	-	-	-	1,058,260	1,058,260	-
177,807	177,807	-	335,451	335,451	-	4,558,608	4,558,608	-
-	-	-	28,260	28,260	-	28,260	28,260	-
-	-	-	130,168	130,168	-	130,168	130,168	-
-	-	-	104,523	85,957	18,565	104,523	85,957	18,565
153,661	151,661	2,000	-	-	-	153,661	151,661	2,000
-	-	-	45,000	45,000	-	45,000	45,000	-
-	-	-	-	-	-	179,034	171,275	7,759
-	-	-	-	-	-	4,076,819	3,882,506	194,313
35,061	35,040	21	178,999	178,544	455	214,060	213,584	476
188,723	186,701	2,022	486,950	467,929	19,020	4,931,526	4,708,412	223,113
<u>\$ (10,916)</u>	<u>(8,894)</u>	<u>\$ 2,022</u>	<u>\$ (151,499)</u>	<u>(132,478)</u>	<u>\$ 19,020</u>	<u>\$ (372,917)</u>	<u>(149,804)</u>	<u>\$ 223,113</u>
	390			10,229			88,389	
	<u>(3,996)</u>			<u>(1,637)</u>			<u>(94,646)</u>	
	<u>(3,606)</u>			<u>8,592</u>			<u>(6,256)</u>	
	<u>(12,500)</u>			<u>(123,886)</u>			<u>(156,060)</u>	
	59,407			217,297			1,711,183	
	<u>\$ 46,907</u>			<u>\$ 93,411</u>			<u>\$ 1,555,123</u>	



SPECIAL REVENUE FUNDS - TRANSPORTATION RELATED

STATE AERONAUTICS FUND

Established pursuant to P.A. 327 of 1945, as amended, this fund accounts for airport improvement projects. Financing consists primarily of aviation fuel taxes and federal and local contributions. Although subject to change in the future, annual appropriation acts have allowed any unobligated and unexpended balance at fiscal year-end to lapse and revert to the fund for appropriation in the following year.

STATE TRUNKLINE FUND

Established pursuant to Section 11 of P.A. 51 of 1951, as amended, this fund accounts for highway construction and maintenance. Its annual budget is subject to legislative review and appropriation, but the Transportation Commission has significant discretion in determining the funding of individual projects. Financing consists primarily of federal aid, local participation, and transfers from the Michigan Transportation Fund. Expenditures and transfers are for administration, highway maintenance and construction, debt service, and various contractual obligations. Although subject to change in the future, annual appropriation acts have allowed for any fund balance not otherwise reserved at fiscal year-end to be reserved for road and bridge construction.

This fund also is used to record loans made to local units of government for reconstructing and resurfacing roadways. Activities of the Blue Water Bridge program, segregated as a separate fund within the accounting system, are also reported within the State Trunkline Fund. A portion of the receivables and payables between the State Trunkline Fund and the Blue Water Bridge Fund are classified as current and are presented as "Amounts due from other funds" and "Amounts due to other funds". The remainder is classified as long-term "Advances from other funds" and "Advances to other funds" because repayment will not occur within the next 12 months.

MICHIGAN TRANSPORTATION FUND

Established pursuant to Section 10 of P.A. 51 of 1951, as amended, this fund accounts for the receipt and distribution of several tax revenues dedicated for highway purposes. Transfers are made to the General Fund, State Trunkline Fund, and the Comprehensive Transportation Fund. Expenditures include grants to counties, cities, and villages for highway purposes.

COMPREHENSIVE TRANSPORTATION FUND

This fund operates under Section 10(b) of P.A. 51 of 1951, as amended, and accounts for the planning and development of public transportation systems within the State. Federal and local revenues, vehicle-related sales tax, and transfers from the Michigan Transportation Fund provide financing for expenditures. In accordance with statutory provisions, any unencumbered balance at fiscal year-end lapses and reverts to the fund for appropriation in the following year.

COMBINED STATE TRUNKLINE BOND PROCEEDS FUND

Established pursuant to Section 18(b) of P.A. 51 of 1951, as amended, this fund accounts for the proceeds of State trunkline revenue dedicated bonds. These bonds are used in part to finance the costs of road and bridge construction.

COMBINED COMPREHENSIVE TRANSPORTATION BOND PROCEEDS FUND

Established pursuant to Section 18(b) of P.A. 51 of 1951, as amended, this fund accounts for the proceeds of comprehensive transportation revenue dedicated bonds. These bonds are used in part to finance the construction and acquisition of comprehensive transportation projects.

TRANSPORTATION RELATED TRUST FUNDS

The transportation related trust funds reflects the activities of five sub-funds: the Special Federal Bridge Replacement Fund, the Federal County Road Fund, the Federal Urban Transportation System Fund, the Highway Topics and Safety Program Fund, and the Metropolitan Planning Fund. The Michigan Department of Transportation is recognized as the legal representative of the State, including all governmental subdivisions, in the administration of these programs. The financing accounted for in these funds consists primarily of local and federal matching funds with very little State funds. Financing provided prior to expenditures being incurred is recorded as deferred revenue and revenue is recognized as expenditures are made. As a result, the fund balances of these funds are usually zero.

Michigan

COMBINING BALANCE SHEET
SPECIAL REVENUE FUNDS - TRANSPORTATION RELATED
 SEPTEMBER 30, 2002
 (In Thousands)

	STATE AERONAUTICS FUND	STATE TRUNKLINE FUND	MICHIGAN TRANSPORTATION FUND	COMPREHENSIVE TRANSPORTATION FUND
ASSETS				
Current Assets:				
Cash	\$ 435	\$ 1,078	\$ -	\$ -
Equity in common cash	21,554	477,331	208,954	59,308
Taxes, interest, and penalties receivable	1,051	-	121,264	-
Amounts due from other funds	-	47,412	-	12,848
Amounts due from component units	-	711	-	-
Amounts due from federal agencies	44,418	102,321	-	6,247
Amounts due from local units	14,524	28,213	-	361
Inventories	-	8,287	-	-
Other current assets	84	8,784	7,429	406
Total Current Assets	82,067	674,137	337,647	79,171
Taxes, interest, and penalties receivable	15	-	4,307	-
Advances to other funds	-	27,734	-	-
Amounts due from local units	790	35,566	-	3,713
Other noncurrent assets	-	3,007	-	2,604
Total Assets	\$ 82,872	\$ 740,444	\$ 341,954	\$ 85,488
LIABILITIES AND FUND BALANCES				
Current Liabilities:				
Warrants outstanding	\$ 613	\$ 6,913	\$ 654	\$ 2,398
Accounts payable and other liabilities	63,375	135,525	236,958	11,134
Amounts due to other funds	17	3,057	78,060	12,778
Deferred revenue	4,941	9,497	21,974	-
Total Current Liabilities	68,946	154,992	337,647	26,311
Long-Term Liabilities:				
Advances from other funds	-	27,734	-	-
Deferred revenue	15	14,671	4,307	2,604
Total Liabilities	68,961	197,397	341,954	28,915
Fund Balances:				
Reserves for:				
Budgetary carry-forwards:				
Encumbrances	2,874	21,128	-	38,713
Restricted revenues	-	232,920	-	6,332
Multi-year projects	7,816	195,604	-	430
Construction and debt service	-	45,315	-	-
Revolving loan programs	2,200	18,390	-	11,000
Noncurrent assets	-	29,690	-	-
Total Reserved	12,890	543,047	-	56,475
Unreserved	1,021	-	-	98
Total Fund Balances	13,912	543,047	-	56,573
Total Liabilities and Fund Balances	\$ 82,872	\$ 740,444	\$ 341,954	\$ 85,488

Michigan

COMBINED STATE TRUNKLINE BOND PROCEEDS FUND	COMBINED COMPREHENSIVE TRANSPORTATION BOND PROCEEDS FUND	TRANSPORTATION RELATED TRUST FUNDS	TOTALS SEPTEMBER 30, 2002
\$ 4	\$ -	\$ 625	\$ 2,142
434,171	90,708	-	1,292,026
-	-	-	122,315
1,162	-	-	61,422
-	-	-	711
5,430	-	33,871	192,287
501	-	15,207	58,806
-	-	-	8,287
136	-	117	16,957
<u>441,405</u>	<u>90,708</u>	<u>49,820</u>	<u>1,754,955</u>
-	-	-	4,322
-	-	-	27,734
-	-	-	40,069
-	-	-	5,611
<u>\$ 441,405</u>	<u>\$ 90,708</u>	<u>\$ 49,820</u>	<u>\$ 1,832,691</u>
\$ 597	\$ 88	\$ 670	\$ 11,932
30,108	354	42,538	519,993
-	-	1,162	95,075
529	-	5,451	42,392
<u>31,234</u>	<u>442</u>	<u>49,820</u>	<u>669,392</u>
-	-	-	27,734
-	-	-	21,597
<u>31,234</u>	<u>442</u>	<u>49,820</u>	<u>718,722</u>
-	-	-	62,716
-	-	-	239,252
-	-	-	203,850
-	-	-	45,315
-	-	-	31,590
-	-	-	29,690
<u>-</u>	<u>-</u>	<u>-</u>	<u>612,412</u>
410,171	90,266	-	501,556
<u>410,171</u>	<u>90,266</u>	<u>-</u>	<u>1,113,968</u>
<u>\$ 441,405</u>	<u>\$ 90,708</u>	<u>\$ 49,820</u>	<u>\$ 1,832,691</u>

Michigan

COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE FUNDS - TRANSPORTATION RELATED
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

	STATE AERONAUTICS FUND	STATE TRUNKLINE FUND	MICHIGAN TRANSPORTATION FUND	COMPREHENSIVE TRANSPORTATION FUND
REVENUES				
Taxes	\$ 6,699	\$ -	\$ 1,910,117	\$ 78,819
From federal agencies	106,090	567,187	-	27,789
From local agencies	16,351	31,514	-	43
From services	838	-	-	-
From licenses and permits	286	15,794	58,024	294
Miscellaneous	756	48,394	4,754	1,981
Total Revenues	131,020	662,889	1,972,895	108,926
EXPENDITURES				
Current:				
Transportation	159,330	508,890	920,948	244,144
Capital outlay	-	792,762	-	-
Debt service:				
Capital lease payments	-	252	-	-
Total Expenditures	159,330	1,301,903	920,948	244,144
Excess of Revenues over (under) Expenditures	(28,310)	(639,014)	1,051,947	(135,218)
OTHER FINANCING SOURCES (USES)				
Bonds and notes issued	-	-	-	-
Premium on bond issuance	-	-	-	-
Transfers from other funds	24,599	830,788	1,340	161,769
Transfers to other funds	(279)	(95,720)	(1,053,286)	(44,180)
Total Other Financing Sources (Uses)	24,321	735,067	(1,051,947)	117,589
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses	(3,990)	96,054	-	(17,629)
Fund Balances - Beginning of fiscal year	17,901	446,993	-	74,202
Fund Balances - End of fiscal year	\$ 13,912	\$ 543,047	\$ -	\$ 56,573

Michigan

COMBINED STATE TRUNKLINE BOND PROCEEDS FUND	COMBINED COMPREHENSIVE TRANSPORTATION BOND PROCEEDS FUND	TRANSPORTATION RELATED TRUST FUNDS	TOTALS SEPTEMBER 30, 2002
\$ -	\$ -	\$ -	\$ 1,995,635
49,334	-	194,139	944,540
6,679	-	78,687	133,273
-	-	-	838
-	-	-	74,398
8,470	251	11	64,617
<u>64,482</u>	<u>251</u>	<u>272,838</u>	<u>3,213,301</u>
3	6,143	277,694	2,117,153
364,016	-	-	1,156,778
-	-	-	252
<u>364,019</u>	<u>6,143</u>	<u>277,694</u>	<u>3,274,182</u>
(299,537)	(5,892)	(4,856)	(60,881)
200,000	82,310	-	282,310
-	6,722	-	6,722
8,640	-	4,888	1,032,024
(16,068)	(3)	(32)	(1,209,568)
<u>192,572</u>	<u>89,030</u>	<u>4,856</u>	<u>111,489</u>
(106,965)	83,138	-	50,608
<u>517,136</u>	<u>7,128</u>	<u>-</u>	<u>1,063,361</u>
<u>\$ 410,171</u>	<u>\$ 90,266</u>	<u>\$ -</u>	<u>\$ 1,113,968</u>

**COMBINING SCHEDULE OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL -
SPECIAL REVENUE FUNDS - TRANSPORTATION RELATED**
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

<u>Statutory/Budgetary Basis</u>	STATE AERONAUTICS FUND		
	BUDGET	ACTUAL	VARIANCE
REVENUES AND OTHER SOURCES			
Taxes	\$ 6,699	\$ 6,699	\$ -
From federal agencies	106,090	106,090	-
From local agencies	16,351	16,351	-
From services	838	838	-
From licenses and permits	286	286	-
Miscellaneous	756	756	-
Transfers in	24,599	24,599	-
Total Revenues and Other Sources	155,619	155,619	-
EXPENDITURES, TRANSFERS OUT, AND ENCUMBRANCES - BY BRANCH, DEPARTMENT/AGENCY			
Transportation	164,397	162,483	1,914
Total Expenditures, Transfers Out, and Encumbrances	164,397	162,483	1,914
Revenues and Other Sources over (under) Expenditures, Encumbrances, and Other Uses (Statutory/budgetary basis)	<u>\$ (8,778)</u>	<u>(6,864)</u>	<u>\$ 1,914</u>
Reconciling Items:			
Encumbrances at September 30		2,874	
Funds not annually budgeted		-	
Net Reconciling Items		2,874	
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses (GAAP Basis)		(3,990)	
FUND BALANCES (GAAP BASIS)			
Beginning balances		17,901	
Ending balances (GAAP Basis)		<u>\$ 13,912</u>	

Michigan

STATE TRUNKLINE FUND			MICHIGAN TRANSPORTATION FUND		
BUDGET	ACTUAL	VARIANCE	BUDGET	ACTUAL	VARIANCE
\$ -	\$ -	\$ -	\$ 1,910,117	\$ 1,910,117	\$ -
567,187	567,187	-	-	-	-
31,514	31,514	-	-	-	-
-	-	-	-	-	-
15,794	15,794	-	58,024	58,024	-
48,394	48,394	-	4,754	4,754	-
830,788	830,788	-	1,340	1,340	-
1,493,677	1,493,677	-	1,974,234	1,974,234	-
1,558,326	1,418,752	139,574	2,010,217	1,974,234	35,983
1,558,326	1,418,752	139,574	2,010,217	1,974,234	35,983
\$ (64,649)	74,925	\$ 139,574	\$ (35,983)	-	\$ 35,983
	21,128			-	
	-			-	
	21,128			-	
	96,054			-	
	446,993			-	
	\$ 543,047			\$ -	

This schedule continued on next page.

**COMBINING SCHEDULE OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL -
SPECIAL REVENUE FUNDS - TRANSPORTATION RELATED (Continued)**
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

<u>Statutory/Budgetary Basis</u>	COMPREHENSIVE TRANSPORTATION FUND		
	BUDGET	ACTUAL	VARIANCE
REVENUES AND OTHER SOURCES			
Taxes	\$ 78,819	\$ 78,819	\$ -
From federal agencies	27,789	27,789	-
From local agencies	43	43	-
From services	-	-	-
From licenses and permits	294	294	-
Miscellaneous	1,981	1,981	-
Transfers in	161,769	161,769	-
Total Revenues and Other Sources	270,695	270,695	-
EXPENDITURES, TRANSFERS OUT, AND ENCUMBRANCES - BY BRANCH, DEPARTMENT/AGENCY			
Transportation	343,879	327,037	16,842
Total Expenditures, Transfers Out, and Encumbrances	343,879	327,037	16,842
Revenues and Other Sources over (under) Expenditures, Encumbrances, and Other Uses (Statutory/budgetary basis)	\$ (73,184)	(56,342)	\$ 16,842
Reconciling Items:			
Encumbrances at September 30		38,713	
Funds not annually budgeted		-	
Net Reconciling Items		38,713	
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses (GAAP Basis)		(17,629)	
FUND BALANCES (GAAP BASIS)			
Beginning balances		74,202	
Ending balances (GAAP Basis)		\$ 56,573	

Michigan

FUNDS NOT ANNUALLY BUDGETED					
COMBINED STATE TRUNKLINE BOND PROCEEDS FUND	COMBINED COMPREHENSIVE TRANSPORTATION BOND PROCEEDS FUND	TRANSPORTATION RELATED TRUST FUNDS	TOTALS		
ACTUAL	ACTUAL	ACTUAL	BUDGET	ACTUAL	VARIANCE
\$ -	\$ -	\$ -	\$ 1,995,635	\$ 1,995,635	\$ -
-	-	-	701,066	701,066	-
-	-	-	47,907	47,907	-
-	-	-	838	838	-
-	-	-	74,398	74,398	-
-	-	-	55,886	55,886	-
-	-	-	1,018,496	1,018,496	-
-	-	-	3,894,226	3,894,226	-
-	-	-	4,076,819	3,882,506	194,313
-	-	-	4,076,819	3,882,506	194,313
-	-	-	\$ (182,594)	11,719	\$ 194,313
-	-	-		62,716	
(106,965)	83,138	-		(23,828)	
(106,965)	83,138	-		38,888	
(106,965)	83,138	-		50,608	
517,136	7,128	-		1,063,361	
\$ 410,171	\$ 90,266	\$ -		\$ 1,113,968	

SPECIAL REVENUE FUNDS – CONSERVATION, ENVIRONMENT, AND RECREATION RELATED

GAME AND FISH PROTECTION FUND

Established in 1921, this fund currently operates under Part 435 of P.A. 451 of 1994, as amended, and is financed principally by the sale of hunting and fishing licenses. The license fees are set by statute and their purpose is to support the conservation program for preservation and control of fish and wildlife. The fund also receives funding from the Game and Fish Protection Trust Fund. The fund provides financial support for statewide hunting and fishing programs, including resource management, research, enforcement of hunting and fishing laws, and acquisition of lands to be used for hunting and fishing purposes.

MICHIGAN STATE WATERWAYS FUND

Established in 1947, this fund currently operates under Part 781 of P.A. 451 of 1994, as amended. The fund receives portions of watercraft registration fees and gasoline taxes, some of which are collected by other State agencies and transferred to this fund. The fund provides for improvement of lake harbors and inland waterways; construction, operation, and maintenance of recreational boating facilities; property acquisition; and administration.

MARINE SAFETY FUND

Established in 1967, this fund currently operates under Part 801 of P.A. 451 of 1994, as amended. The fund is financed principally by 49% of watercraft registration fees imposed by this act. The fund provides for water safety education programs, law enforcement, and regulation of watercraft on the waters of this State.

GAME AND FISH PROTECTION TRUST FUND

This fund was established in 1986 and presently operates under Part 437 of P.A. 451 of 1994, as amended, to restrict certain assets for the purpose of generating interest and earnings for transfer to the Game and Fish Protection Fund. In addition, the Legislature may appropriate up to \$6 million annually for use by the Game and Fish Protection Fund. Mineral royalties from lands acquired by the Game and Fish Protection Fund; direct sale proceeds; and other revenues, which, by statute, are retained for permanent investment, provide additional investment funding.

STATE PARK IMPROVEMENT FUND

Established in 1960, this fund currently operates under Part 741 of P.A. 451 of 1994, as amended. The fund is primarily financed by State park use and concession fees and motor vehicle permit fees necessary for entry by motor vehicles into designated State parks. These fees are the primary funding source for the operation, maintenance, and improvements of the State Park system. Revenues of this fund are pledged as necessary for repayment of State Park Gross Revenue Bonds.

COMBINED RECREATION BOND FUND - LOCAL PROJECTS

Established in 1988, this fund presently operates under Parts 196 and 715 of P.A. 451 of 1994, as amended. The residual balances in this fund reflect proceeds and investment earnings remaining from two bond packages: \$70 million of general obligation bonds approved by voters in November 1988, as part of a \$140 million bond package for financing state and local public recreation projects, and \$50 million of general obligation bonds approved by voters in November of 1998, as part of a \$675 million bond package known as the "Clean Michigan Initiative." Proceeds from the 1988 bond package provide grants and loans to local units of government in the amounts of \$65 million for local recreation projects and \$5 million to discourage development of open space and underdeveloped lands. Proceeds from the 1998 bond package also provide grants to local units of government for local recreation projects pursuant to Part 716 of P.A. 451 of 1994.

COMBINED ENVIRONMENTAL PROTECTION BOND FUND

Established by P.A. 328 of 1988, this fund accounts for the proceeds of \$660 million of general obligation bonds approved by Michigan voters in November 1988 to finance environmental protection programs. This approval was obtained under the general authority of Article 9, Section 15, of the 1963 State Constitution. Public Act 328 of 1988 specifies that not more than \$425 million of the bond proceeds be available to clean up sites of toxic and other environmental contamination; not more than \$150 million be available for solid waste projects; not more than \$60 million be available to capitalize the State Water Pollution Control Loan Fund; and not more than \$25 million be available to fund Michigan's participation in a regional Great Lakes Protection Fund.

Public Act 284 of 1998 expanded this fund to account for the proceeds of \$570 million of general obligation bonds approved by Michigan voters in November 1998. Public Act 288 of 1998 directs that not more than \$335 million be used for environmental response activities; not more than \$50 million for waterfront improvements; not more than \$25 million for remediation of contaminated lake and river sediments; not more than \$50 million for nonpoint source pollution prevention and control projects or wellhead protection projects; not more than \$90 million for water quality monitoring and water resources protection and pollution control activities; and not more than \$20 million for pollution prevention programs.